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Supreme Court, U.S.
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No. ____

IN THE
Supreme Court of the United States

October Term, 1994

COMPUTER CURRICULUM CORPORATION,

Petitioner,

v.

INSTRUCTIONAL SYSTEMS, INC.
and
DEBORAH T. PORITZ, ATTORNEY GENERAL
OF THE STATE OF NEW JERSEY,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether, under the dormant Commerce Clause, a state franchise termination statute may be applied extraterritorially to prohibit commercial transactions occurring wholly outside the State's borders and to prevent out-of-state suppliers, potentially in perpetuity, from changing the way they distribute their products to consumers in other States.

2. Whether a federal court of appeals may avoid invalidating such a state statute by attributing the source of the extraterritoriality to the parties' contract rather than to the statute itself, despite a contrary reading of state law by the State's highest court; despite the fact that, absent the statute, the contract would have expired five years ago; and despite well-accepted principles of unconstitutional conditions and state action.

3. Whether, in performing the Commerce Clause balancing test for facially neutral state laws prescribed by *Pike* v. *Bruce Church, Inc.*, 397 U.S. 137 (1970), a court may refuse to consider as part of the burden on interstate commerce "the effect of the state regulation on the commerce of other states."

PARTIES TO THE PROCEEDING AND RULE 29.1 STATEMENT

The parties to the proceeding below were the petitioner, Computer Curriculum Corporation, the defendant in the action; respondent Instructional Systems, Inc., the plaintiff in the action; and respondent Deborah T. Poritz, the Attorney General of the State of New Jersey, who intervened in the action to defend the constitutionality of the New Jersey statute in question.

Petitioner is an indirect wholly-owned subsidiary of Viacom, Inc. Petitioner has no subsidiaries to list pursuant to Rule 29.1.

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OPINIONS BELOW

The opinion of the United States Court of Appeals for the Third Circuit is reported at 35 F.3d 813, and is reprinted as Appendix A in the separately bound Appendix accompanying this Petition. (1a-30a) The June 2, 1993 decision and order of the United States District Court for the District of New Jersey, 826 F. Supp. 831, granting summary judgment to petitioner on respondent's New Jersey Franchise Practices Act claim, is reprinted as Appendix B. (31a-83a) The opinion of the Supreme Court of New Jersey construing the statute in question during abstention proceedings, 614 A.2d 124, is reprinted as Appendix C. (84a-144a) The November 9, 1993 unpublished decision of the United States District Court for the District of New Jersey granting summary judgment to petitioner on respondent's common-law claims is reprinted as Appendix D. (145a-256a)

JURISDICTION

The decision of the court of appeals issued on September 16, 1994. Petitioner Computer Curriculum Corporation filed a timely petition for rehearing and rehearing in banc; respondent Instructional Systems, Inc. also filed a timely petition for rehearing. Both petitions were denied on November 3, 1994. *See* Appendix E (257a-260a). The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS

The Commerce Clause provides that "The Congress shall have Power . . . to regulate Commerce with foreign Nations, and among the several States." U.S. Const., Art. I, § 8, cl. 3.

The New Jersey Franchise Practices Act, N.J. Stat. § 56:10-1, *et seq.* (1993), is reprinted insofar as its provisions are relevant here as Appendix F. (261a-266a) Section 56:10-5 of the statute provides, in pertinent part:

> It shall be a violation of this act for a franchisor to terminate, cancel or fail to renew a franchise without good cause. For the purposes of this act, good cause for terminating, canceling, or failing to renew a franchise shall be limited to failure by the franchisee to substantially comply with those requirements imposed upon him by the franchise.

STATEMENT OF THE CASE

This case involves the constitutionality, under the dormant Commerce Clause, of the New Jersey Franchise Practices Act, N.J. Stat. § 56:10-1, *et seq.* ("NJFPA"), insofar as it may be applied extraterritorially to regulate interstate distribution activities beyond New Jersey's borders.

New Jersey is one of a small minority of States that have adopted statutes regulating the termination and renewal of franchise or distribution relationships. Under the NJFPA, a franchisee with a "place of business within the State of New Jersey" can compel renewal of a franchise agreement after the agreement has expired unless "good cause" can be shown. N.J. Stat. § 56:10-4, -5. Because "good cause" is restricted to a showing of material breach of a franchisee's obligations and does not include bona fide business reasons, *see Westfield Centre Serv., Inc.* v. *Cities Serv. Oil Co.*, 432 A.2d 48, 55-57 (N.J. 1981), the effect of the NJFPA is to create franchises that may be "infinite" in duration. *Dunkin' Donuts of Am., Inc.* v. *Middletown Donut Corp.*, 495 A.2d 66, 76 (N.J. 1985).

In this case, a New Jersey-based distributor seeks to use the NJFPA to create such an "infinite" franchise in eight States *outside* New Jersey by compelling petitioner to renew an exclusive distribution agreement after it expired by its terms. The United States Court of Appeals for the Third Circuit held that the dormant Commerce Clause does not prevent such extraterritorial application of the NJFPA, even though it concededly would have the practical effect of controlling commerce wholly outside New Jersey's

borders: It would prohibit petitioner, a California software company, from selling its products directly to consumers or otherwise changing its method of distribution in other States. The court of appeals circumvented the Commerce Clause's *per se* prohibition on extraterritorial regulation of commerce by invoking the legal fiction that petitioner "agreed" to regulation of its out-of-state activities by entering into a multistate contract with the New Jersey distributor. The court also refused to consider "the effect of the state regulation on the commerce of other states" as part of the balancing test of *Pike* v. *Bruce Church, Inc.*, 397 U.S. 137 (1970).

Review by this Court is urgently needed to prevent the erosion of basic Commerce Clause principles. And the instant case is an excellent vehicle to do so. The constitutional questions are posed in a stark and procedurally unclouded form. There are no questions regarding the proper interpretation of the New Jersey statute, for during abstention proceedings below the New Jersey Supreme Court provided an authoritative construction of the law.

Moreover, the case at bar involves a matter of enormous practical importance for businesses nationwide: the extraterritorial application of franchise termination laws, which limit or, as in this case, remove entirely the power of suppliers engaged in interstate commerce to change distributors or distribution methods in response to dynamic competitive conditions. Because franchise termination laws deprive consumers of the benefits of efficient distribution, most States, as well as Congress, have refused to adopt them. But so long as *any* States are permitted to apply such laws extraterritorially, there will be a substantial distorting effect on interstate commerce; indeed, the fact that many multistate distributors have chosen to locate in New Jersey because of its prime "hub" location means that, under the decision below, New Jersey will be able to regulate a large portion of interstate distribution activities throughout the entire Northeast, or even the nation as a whole, in order to promote its own local economic interests.

Beyond its economic impact, the instant case raises especially important issues of federalism and state sovereignty, for States

applying franchise termination laws extraterritorially are in effect imposing their own controversial policy choices on their sister States and usurping Congress' power to regulate the national economy.

The relevant facts are not in dispute. Petitioner Computer Curriculum Corporation ("CCC") is a Delaware corporation with its principal place of business in California. CCC is an educational software company founded in the late 1960s by two professors at Stanford University. It pioneered the development of "integrated learning systems," a method of using computers to assist students to improve their skills in math, science, reading, and other subjects. In the mid-1970s, when both the industry and CCC were still in their formative stages, CCC appointed respondent Instructional Systems, Inc. ("ISI"), a New Jersey corporation, as its exclusive distributor in the Northeast. Although ISI's offices are in New Jersey, the great majority of its sales have occurred in other States.[1] J.A. 893.[2]

From its inception, the CCC-ISI relationship was governed by a succession of written contracts. Each contract has been for a definite term, consistent with the general practice of computer manufacturers to retain flexibility in their distribution arrangements in order to adjust to changing market conditions. Early in the relationship, CCC rejected a proposal by ISI for a perpetual distributorship because, as ISI's owner explained, "the market changes. The computer industry is very dynamic." J.A. 897.

In 1984, CCC and ISI signed a five-year contract (the "1984 Agreement") providing that ISI would be the exclusive distributor of certain CCC products to school districts and other customers in

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[1] Because of the parties' diverse citizenship, and the fact that the amount in controversy exceeded $50,000, the district court had jurisdiction of this case pursuant to 28 U.S.C. § 1332(a)(1); the court of appeals had jurisdiction pursuant to 28 U.S.C. § 1291, following certification by the district court under Fed. R. Civ. P. 54(b). (11a)

[2] Citations to the Joint Appendix in the court of appeals are styled "J.A. ___."

eleven States: Connecticut, Delaware, the District of Columbia, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island, and Vermont. The agreement expressly provided that it would "continue in effect until July 31, 1989," after which all rights granted to ISI would revert to CCC. J.A. 921, 929. It also explicitly provided that it would be governed by California law. J.A. 934.

During the five-year term of the 1984 Agreement, the educational software market changed dramatically, with many new entrants and intensifying competition. J.A. 876-81, 1056. At the same time, CCC grew concerned that ISI was not aggressively selling in eight of the States covered by the 1984 Agreement. In some of those States, ISI had not made *any* sales for years. J.A. 892-93, 901-02. Accordingly, CCC offered ISI a new contract, to take effect on expiration of the 1984 Agreement, limiting ISI's territory to New Jersey, New York, and Massachusetts (places in which ISI conducted almost all of its business). J.A. 909-11. CCC planned to distribute its products directly in the eight other States previously served by ISI.

ISI signed the new contract and simultaneously filed suit in New Jersey Superior Court, seeking an injunction to prohibit CCC from marketing its products in the eight States except through ISI. ISI argued that, under the NJFPA, CCC was compelled to renew the 1984 Agreement notwithstanding the contract's expiration date.[2]

The case was removed on diversity grounds to the U.S.

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[2] ISI also asserted claims under a number of common-law theories, including a claim that the parties had orally agreed that ISI's contract would be renewed unless CCC had good cause for nonrenewal. The district court granted summary judgment to CCC on all of ISI's common-law claims. The court ruled, for example, that the 1984 Agreement was "clear and unambiguous" that it would terminate on July 31, 1989 and that there was no evidence of any oral agreement to the contrary. (224a-234a) The Third Circuit affirmed the district court's dismissal of ISI's common-law claims. (29a) There remains pending in the district court a separate claim by ISI that the new three-state contract imposes "unreasonable standards of performance" in violation of N.J. Stat. § 56:10-7e.

District Court for the District of New Jersey. ISI persuaded the district court to abstain from deciding CCC's claim that application of the NJFPA to business outside New Jersey would violate the Commerce Clause, in order to allow a state court resolution of state-law questions concerning the scope and applicability of the NJFPA. The district court reserved the constitutional question, in accordance with *England* v. *Louisiana State Bd. of Medical Examiners*, 375 U.S. 411 (1964).

Three years of proceedings ensued in the New Jersey courts. Eventually, the New Jersey Supreme Court held, by a 5-2 vote, that ISI possessed a "franchise" within the meaning of the NJFPA. The court also held that the NJFPA can be applied not only to regulate distribution activities within New Jersey, but also to regulate distribution activities outside New Jersey. The court specifically found that the New Jersey legislature intended to apply the NJFPA extraterritorially in order to protect New Jersey franchisees engaged in interstate commerce outside New Jersey's borders. The court explained: "we are remitted to the question of whether *the New Jersey Legislature* intended the Act to apply to franchise activities outside of the state. . . . [W]ould *the Legislature* have intended to protect a New Jersey businessperson that had invested substantial assets in a New Jersey-based hub of a multi-state franchise operation?" (129a; emphasis added) The court had previously answered this question in the affirmative, in holding that New Jersey's "strong policy in favor of protecting its franchisees," as embodied in the NJFPA, compelled it to override the parties' choice of California law, even with respect to activities outside New Jersey. (107a) "[T]he purpose behind franchise-act legislation is that dealers geographically situated in a forum state are to be the desired beneficiaries of the legislation in order to make their bargaining position more equal to manufacturers['']. To strip away the spokes of a 'hub-type' franchise would counter the purpose of such legislation." (106a; citation and internal quotation marks omitted) The court admitted that its reading of the NJFPA produced "some incidental extraterritorial effects" (132a), but opined that extraterritorial application of the statute nonetheless survived

Commerce Clause scrutiny. (129a-132a)[4]

When the case returned to federal court, the district court held that extraterritorial application of the NJFPA to compel renewal of ISI's exclusive distributorship in portions of its territory outside New Jersey would violate the Commerce Clause. In a thorough and well-reasoned opinion, the court explained that such application would "(1) regulate distribution of CCC's products within other states, (2) prevent CCC from changing its method of distribution in these states and (3) prohibit interstate transactions between CCC and school districts in these states." (60a) The court therefore granted summary judgment to CCC dismissing ISI's claim under the NJFPA to compel renewal in the eight States.

But the Court of Appeals for the Third Circuit reversed. The court of appeals never questioned that compelling renewal of the exclusive distribution agreement in the eight States would have the extraterritorial effects described by the district court. The court of appeals also acknowledged that, under *Healy* v. *Beer Institute*, 491 U.S. 324, 336-37 (1989), a state law with the "practical effect" of regulating commerce wholly outside the State is *per se* invalid under the Commerce Clause. Nevertheless, the Third Circuit refused to apply *Healy* to this case.

Instead, the court of appeals drew upon what it called "choice-of-law" principles and reasoned that "there is nothing untoward about applying one state's law to [an] entire [multistate] contract, even if it requires applying that state's law to activities outside the state." (25a) The court of appeals then treated the NJFPA as if it were an "ordinary state contract rule" that was "no more or less regulatory" than rules of contract interpretation. (25a) The Third Circuit reasoned that, because CCC agreed to enter into an exclusive multistate distribution contract with a New Jersey company, "it was the parties' own agreement which operated to

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[4] As the Third Circuit subsequently held, the views of the New Jersey Supreme Court on the Commerce Clause issue are of no preclusive effect, because CCC properly preserved its right under *England* to a federal court determination of this issue. (16a-18a)

project the New Jersey law outside of New Jersey's borders." (26a) The court of appeals acknowledged that CCC would find this surprising result "ironic," but nonetheless maintained that it followed from choice-of-law principles. (26a) The court concluded that *Healy* was distinguishable because here it was "the parties' contract," not "the state," which "dictated the extraterritorial effect." (26a)

The court of appeals also sustained the statute under the *Pike* balancing test by refusing to consider as part of the burden on interstate commerce "the effect of the state regulation on the commerce of other states." (28a) The court held that, because "the NJFPA is facially neutral," it "creates no incidental burdens on interstate commerce for purposes of *Pike* balancing." (29a)

The court of appeals decision would remand the case to the district court, forcing CCC to go to trial on ISI's claims under the NJFPA—notwithstanding CCC's objection that such a trial would itself impinge on the very Commerce Clause protections that CCC is seeking to enforce in this case. As the district court observed, the NJFPA is "compel[ling] CCC to undergo protracted litigation to exercise a right that New Jersey cannot constitutionally regulate—namely, the right of a non-New Jersey corporation to market and sell its products in states outside o[f] New Jersey." (66a)

On November 3, the court of appeals denied rehearing and rehearing in banc. Judge Becker would have granted rehearing in banc. (257a-258a) On November 18, the court of appeals granted CCC's motion to stay issuance of the mandate until December 12 to permit the filing of the instant petition for writ of certiorari. *See* Appendix G (267a). Because the Petition has been filed by that date, the stay will automatically continue pending disposition of the case in this Court. Fed. R. Civ. P. 41(b). Accordingly, pending such disposition, no proceedings in the district court will take place.

REASONS FOR GRANTING THE WRIT

I. REVIEW IS WARRANTED BECAUSE THE THIRD CIRCUIT'S DECISION CONFLICTS WITH THIS COURT'S COMMERCE CLAUSE DECISIONS FORBIDDING EXTRATERRITORIAL STATE REGULATION AND WOULD PERMIT INDIVIDUAL STATES TO RESTRICT THE DISTRIBUTION OF GOODS INTO SISTER STATES AND TO USURP CONGRESS' EXCLUSIVE POWER TO REGULATE THE NATIONAL ECONOMY

The New Jersey Supreme Court authoritatively determined that the NJFPA has "extraterritorial reach to the franchise activities in states other than New Jersey." (128a) (heading) This Court should grant the petition for a writ of *certiorari* because the Third Circuit decision, permitting such an extraterritorial reach of a state statute, directly conflicts with this Court's decisions interpreting the Commerce Clause as imposing a *per se* ban on extraterritorial state regulation in the absence of congressional authorization. Review is especially warranted because the extraterritorial application of the NJFPA and other state franchise termination laws would have enormous practical consequences for the interstate distribution of goods and would violate fundamental policies of economic federalism embodied in the Commerce Clause.

1. It is settled that the Commerce Clause "precludes the application of a state statute to commerce that takes place wholly outside of the State's borders, whether or not the commerce has effects within the State." *Healy* v. *Beer Institute*, 491 U.S. 324, 336 (1989) (citation and internal quotation marks omitted). Indeed, such application of a state statute "exceeds the inherent limits of the enacting State's authority and is invalid regardless of whether the statute's extraterritorial reach was intended by the legislature." *Id.* "The critical inquiry is whether the practical effect of the regulation is to control conduct beyond the boundaries of the State." *Id.* Further, "no State may force an out-of-state merchant to seek regulatory approval in one State before undertaking a transaction in another." *Id.* at 337; *accord*, *Brown-Forman Distillers Corp.* v.

New York State Liquor Auth., 476 U.S. 573, 582-83 (1986); *Edgar* v. *MITE Corp.*, 457 U.S. 624, 642-43 (1982) (plurality opinion).[8]

It is also clear that extraterritorial application cannot be justified by the bare fact that a State has legal jurisdiction, as a matter of due process, to regulate a transaction. Thus, the statutes in *Healy* and *Brown-Forman* purported to apply only to transactions occurring within the State and involving state residents. Nonetheless, this Court invalidated the statutes because their practical impact was to regulate out-of-state commerce. "That the [law in question] is addressed only to sales of liquor in New York is irrelevant if the 'practical effect' of the law is to control liquor prices in other States." *Brown-Forman*, 476 U.S. at 583 (citation omitted); *see also Healy*, 491 U.S. at 333-34 n.9; *Edgar* v. *MITE*, 457 U.S. at 642-43 (Commerce Clause forbids extraterritorial effects of Illinois antitakeover statute even though statute applied only if target company had a substantial nexus to Illinois).[9]

Extraterritorial application of the NJFPA violates these principles. By compelling renewal of the CCC-ISI 1984 Agreement in the eight States, the NJFPA would force CCC to distribute its products in States outside New Jersey exclusively, and potentially in perpetuity, through ISI. Hence, the statute's practical effect—

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[8] *See also C&A Carbone, Inc.* v. *Town of Clarkstown*, 114 S. Ct. 1677, 1683 (1994) (municipality may not "steer solid waste away from out-of-town disposal sites that it might deem harmful to the environment" because States and localities may not "control commerce in other states") (citation omitted); *Southern Pac. Co.* v. *Arizona*, 325 U.S. 761, 775 (1945) (striking down an Arizona law limiting the length of railroad trains because the "practical effect of such regulation is to control train operations beyond the boundaries" of Arizona); *Baldwin* v. *G.A.F. Seelig, Inc.*, 294 U.S. 511, 521 (1935) (a State "has no power to project its legislation into [another State] by regulating the price to be paid in that state for milk acquired there"); *New Hampshire Auto. Dealers Assn., Inc.* v. *General Motors Corp.*, 801 F.2d 528, 531-32 (1st Cir. 1986) (Breyer, J.).

[9] *Cf. Quill Corp.* v. *North Dakota*, 112 S. Ct. 1904, 1913 (1992) (holding that state tax on goods purchased in-state from out-of-state mail order house imposes an unconstitutional burden on interstate commerce and indicating that a state tax could have the minimum contacts necessary for jurisdiction under the Due Process Clause and yet fail Commerce Clause scrutiny).

indeed, its direct and immediate effect—is to determine how CCC, a California company, may distribute its products in States outside New Jersey after the parties' agreement has expired. The NJFPA would prevent CCC from selling its products directly to consumers in these States even though CCC would be dealing with *non-residents* of New Jersey, the goods would originate *outside* New Jersey, and the goods would move in interstate commerce *without ever passing through New Jersey*. In addition, the NJFPA requires CCC to seek regulatory approval in New Jersey—to establish to the satisfaction of a New Jersey judge and jury that it is in compliance with New Jersey's regulatory requirements—before it engages in transactions in other States. The very object of ISI's lawsuit is to enjoin CCC from engaging in such transactions unless CCC can meet the NJFPA's "good cause" standard.

The Third Circuit's decision thus plainly conflicts with the Commerce Clause's ban on extraterritorial regulation in the absence of congressional consent.

2. The particular extraterritorial regulation permitted by the Third Circuit is one that is especially repugnant to the principles of economic federalism underlying the dormant Commerce Clause and that has enormous practical implications for interstate commerce.

Franchise termination laws have generated "intense debate and considerable controversy" across the country.[7] Advocates of such statutes argue that they protect franchisees from unfair treatment by franchisors. Opponents argue that they interfere with freedom of contract and are anticompetitive, because they prevent manufacturers from selecting the most efficient means to distribute their products and thereby injure consumers.[8] Notably, the

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[7] American Bar Ass'n, Section on Antitrust Law, *Franchise Protection: Laws Against Termination and the Establishment of Additional Franchises* 2, 19-70 (1990) (analyzing both sides of the public policy debate).

[8] *See, e.g.*, Brickley, Dark & Weisbach, *The Economic Effects of Franchise Termination Laws*, 34 J.L. & Econ. 101, 126 (1991) ("termination laws increase (continued...)

Consumers League of New Jersey opposed the NJFPA when it was adopted in 1971. *Hearing on Assembly Bill No. 2063 Before the New Jersey Assembly Judiciary Comm.*, 194th Leg., 2d Sess. 15-20 (1971) (statement of Paul Krebs).

Congress has refused to enact a federal franchise termination statute. The Antitrust Division of the Department of Justice plainly has an institutional interest to bring to bear on this matter, for during both Democratic and Republican administrations it has opposed such bills as introducing inefficiencies into the distribution process and harming consumers.[2/] It has long been a tenet of federal antitrust policy that: "Competition is promoted when manufacturers are given wide latitude in establishing their method of distribution and in choosing particular distributors. . . . A contrary rule would foster rigidity in distribution arrangements, a result antithetical to a market dependent on vigorous competitive forces." *A.H. Cox & Co.* v. *Star Machinery Co.*, 653 F.2d 1302, 1306 (9th Cir. 1981) (Kennedy, J.).

[1/](...continued)
the costs of franchising and promote economic inefficiency"); Smith, *Franchise Regulation: An Economic Analysis of State Restrictions on Automobile Distribution*, 25 J.L. & Econ. 125, 154 (1982) (concluding that state regulation of automobile franchising has resulted in "a significant increase in vehicle prices—resulting in a large wealth transfer from consumers to dealers and a reduction in the volume of new-vehicle sales").

[2/] *See Hearings on H.R. 5016 Before the Subcomm. on Consumer Protection and Finance of the House Comm. on Interstate and Foreign Commerce*, 95th Cong., 1st Sess. 50 (1977) (proposed Franchising Termination Practices Reform Act, "particularly its failure to renew provisions, could unnecessarily burden the development of the competitive systems of distribution") (testimony of Joe Sims, Deputy Assistant Attorney General, Antitrust Division); *Hearing on S. 1256 Before the Senate Judiciary Comm.*, 97th Cong., 2d Sess. 19-21 (1982) (proposed legislation to require good cause for terminating or failing to renew a dealership to distribute computers or other office products would have "significant anticompetitive effects," forcing consumers to pay for "inefficiencies in the distribution process that might result from the restrictions on suppliers' abilities to appoint and terminate dealers") (statement of William F. Baxter, Assistant Attorney General, Antitrust Division).

The great majority of States also have refused to adopt franchise termination legislation. New Jersey is one of only 18 States that have adopted any form of a franchise termination statute and one of only nine States that compel the renewal of a franchise after its stated expiration date.[10/] Seven of the ten States (other than New Jersey) covered by the CCC-ISI 1984 Agreement do not have such a statute, but instead adhere to the common law rule enforcing the terms of the parties' contract.[11/] In the past year alone, the legislatures of two of these States, Maryland and Maine, have considered and rejected a general franchise termination statute along the lines of New Jersey's.[12/] Yet the Third Circuit's decision means that New Jersey can now impose on those States the very types of restrictions on the right to change distribution methods that they, together with Congress, have rejected. The impact of the NJFPA on other States is magnified because many distributors choose to locate in the central "hub" location of

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[10/] The district court listed 17 States (62a-63a), and Iowa adopted a franchise termination statute during 1993. 2 W.M. Garner, *Franchise and Distribution Law and Practice* § 10.01 (1990 & Supp. 1994). The Mississippi and Missouri statutes only require notice of termination and impose no substantive limit on the franchisor's right to terminate. The statutes in seven other States distinguish between termination and nonrenewal, either permitting the franchisor to provide that the franchise is not renewable or requiring only that the franchisor give sufficient notice of nonrenewal or that the franchisor repurchase the franchisee's inventory and equipment. (62a-63a)

[11/] Of the ten States, only Connecticut, Delaware, and the District of Columbia have adopted franchise termination laws. Unlike the NJFPA, however, the Delaware and D.C. statutes apply only to the prototypical franchise situation where a "franchise fee" is paid. Thus, they would not compel renewal of the kind of distribution agreement involved here, in which no franchise fee was paid. J.A. 217. Notably, the Connecticut statute has been construed as not having extraterritorial effect. *Carlos* v. *Phillips Business Systems, Inc.*, 556 F. Supp. 769, 777 (E.D.N.Y.), *aff'd*, 742 F.2d 1432 (2d Cir. 1983).

[12/] A committee of the Maryland House voted 19-2 against the bill; a Senate committee voted 11-0 against. The Maine legislature elected to limit franchise legislation to the fast-food industry, and even that narrow bill was vetoed by the Governor as harmful to consumers. *See* [Current] Bus. Fran. Guide (CCH) ¶ 2002, at 1609 (Oct. 1994); Int'l Franchise Ass'n, *Franchise Legal Digest* 1 (Summer 1994).

northern New Jersey to market products throughout the entire Northeast. J.A. 1021, 1405.

Extraterritorial application of the NJFPA thus implicates "the Constitution's special concern both with the maintenance of a national economic union unfettered by state-imposed limitations on interstate commerce and with the autonomy of the individual States within their respective spheres." *Healy*, 491 U.S. at 335-36. It represents the kind of regional, and even national, regulation of a vital aspect of a competitive economy that "is reserved by the Commerce Clause to the Federal Government and [that] may not be accomplished piecemeal through the extraterritorial reach of individual state statutes." *Id.* at 340.

3. When applied extraterritorially, the NJFPA interferes with commerce in a fundamentally protectionist manner: it burdens out-of-state transactions by requiring manufacturers to continue distributing their products in other States through New Jersey-based companies regardless of whether more efficient methods of distribution are available that would benefit consumers in other States. The New Jersey Supreme Court noted that the purpose of the NJFPA is to protect in-state commercial interests (101a-107a), and the district court correctly found that the NJFPA was a form of "local protectionism." (71a; *see also* 68a) Here, the statute has been invoked to force a California supplier in the rapidly changing and highly competitive computer industry to do business through a New Jersey company, potentially in perpetuity, rather than distribute its products directly or hire an out-of-state distributor that it believes can do a better job in States that want CCC products to help educate their citizens. "[T]he Court has viewed with particular suspicion state statutes requiring business operations to be performed in the home State that could more efficiently be performed elsewhere." *Pike* v. *Bruce Church, Inc.*, 397 U.S. at 145.[12]

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[12] *See also C&A Carbone, Inc.* v. *Town of Clarkstown*, 114 S. Ct. at 1684 ("State and local governments may not use their regulatory power to favor local enterprise by prohibiting patronage of out-of-state competitors"); *Toomer* v. (continued...)

4. Extraterritorial application of state franchise termination statutes also raises especially important Commerce Clause issues because such laws regulate the *methods* by which goods may be distributed in commerce. In this respect, they are akin to state regulations burdening transportation and other instrumentalities of commerce, which, as this Court has long recognized, raise heightened Commerce Clause concerns.[14] Like those regulations, franchise termination statutes such as the NJFPA cut across industry lines. The decision below thus threatens every manufacturer, in every sector of the economy, that relies on multistate distributors to deliver its goods to consumers. In practical terms, therefore, the instant case is as important as, if not more important than, many of the leading Commerce Clause cases.[15] Moreover, the extraterritorial regulations at issue in *Healy* and *Brown-Forman* affected only the prices at which goods in one particular industry were sold. At stake here is an extraterritorial law that, as applied in cases like this one, has a far more dramatic effect: it prevents out-of-state suppliers from selling directly to

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[13](...continued)
Wiseell, 334 U.S. 385, 403-04 (1948) (requirement that work be done in-state "divert[s] to [one State] employment and business which might otherwise go to [another]; the necessary tendency of the statute is to impose an artificial rigidity on the economic pattern of the industry").

[14] *See, e.g.*, *Bibb* v. *Navajo Freight Lines, Inc.*, 359 U.S. 520 (1959); *Southern Pac. Co.* v. *Arizona*, 325 U.S. 761 (1945). As Professor Regan has explained, regulation of the instrumentalities of commerce merits special judicial scrutiny because "[t]he interest in question is the national interest in an efficient transportation and communications network . . . [which] is important not just to the economy, but also, and more significantly from a constitutional perspective, to the whole project of a political union." Regan, *Siamese Essays: (I) CTS Corp. v. Dynamics Corp. of America and Dormant Commerce Clause Doctrine; (II) Extraterritorial State Legislation*, 85 Mich. L. Rev. 1865, 1883 (1987).

[15] *Compare, e.g.*, *Healy*, 491 U.S. at 335-40 (price of beer); *Hunt* v. *Washington State Apple Advertising Comm'n*, 432 U.S. 333, 349-352 (1977) (North Carolina law that restricted grade identifications on closed apple containers); *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274, 275-76 (1977) (application of Mississippi business tax to shipment of cars by motor carrier into State); *Pike* v. *Bruce Church, Inc.*, 397 U.S. at 139-42 (packaging of cantaloupes).

consumers at any price.[16]

Because of the Commerce Clause's central role in "creat[ing] an area of trade free from interference by the States," *Boston Stock Exchange* v. *State Tax Comm'n*, 429 U.S. 318, 328 (1977), this Court has frequently granted *certiorari* in Commerce Clause cases in the absence of conflicts among the lower courts.[17] But the need for *certiorari* in this case is even plainer, for there is deepening division among the lower courts regarding the constitutionally acceptable scope of state franchise laws under the Commerce Clause. Until now, some lower courts that have considered franchise or dealership termination laws have construed such statutes as not having extraterritorial application, in part to avoid Commerce Clause concerns.[18] But other courts have

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[16] While the impact is especially dramatic in cases such as this one where the distributor has exclusive rights, extraterritorial application of the NJFPA to compel renewal of a non-exclusive distribution arrangement would equally offend the Commerce Clause. It would force a supplier to engage in dual distribution in other States and prevent it from hiring a different distributor on an exclusive basis (or vertically integrating and handling the distribution itself), solely in order to assure that New Jersey's citizens receive perpetual benefits from commerce flowing entirely outside New Jersey's borders.

[17] *E.g.*, *West Lynn Creamery, Inc.* v. *Healy*, 114 S. Ct. 2205 (1994); *Associated Industries of Missouri* v. *Lohman*, 114 S. Ct. 1815 (1994). Indeed, in *Fort Gratiot Sanitary Landfill, Inc.* v. *Michigan Dep't of Natural Resources*, 112 S. Ct. 2019, 2023 (1992), this Court explained that it granted *certiorari* not because of any conflict among the lower courts but "because of concern that the decision below was inconsistent with *Philadelphia* v. *New Jersey*, [437 U.S. 617 (1978)]." *See also Chemical Waste Management, Inc.* v. *Hunt*, 112 S. Ct. 2009, 2012 (1992) (granting *certiorari* "[b]ecause of the importance of the federal question and the likelihood that it had been decided in a way conflicting with applicable decisions of this Court, Supreme Court Rule 10.1(c)").

[18] *Kansas City Trailer Sales* v. *Holiday Rambler Corp.*, 1994 WL 57400 (W.D. Mo. 1994); *Wright-Moore Corp.* v. *Ricoh Corp.*, 794 F. Supp. 844, 860-61 (N.D. Ind. 1991), *aff'd on other grounds*, 980 F.2d 432 (7th Cir. 1992); *Carlos* v. *Philips Business Systems, Inc.*, 556 F. Supp. 769, 777 (E.D.N.Y.), *aff'd*, 742 F.2d 1432 (2d Cir. 1983); *see also Central GMC, Inc.* v. *General Motors Corp.*, 946 F.2d 327, 334-35 (4th Cir. 1991) (rejecting construction of (continued...)

disagreed,[12] and the Third Circuit has now provided important support to those who would allow States to restrict interstate commerce beyond their borders. And if one State can give its corporations passports to do business in perpetuity in other States, then competition to enact extraterritorial legislation promoting one State's economic interests at the expense of other States cannot be far behind. The need for this Court's guidance is plain.

II. REVIEW IS INDEPENDENTLY WARRANTED BECAUSE THE LEGAL FICTIONS EMPLOYED BY THE THIRD CIRCUIT WOULD SERIOUSLY ERODE THE PROTECTIONS OF THE COMMERCE CLAUSE

The Third Circuit believed that it could avoid the restrictions of the Commerce Clause by recasting the issue as involving the choice of the appropriate state-law "contract rule" to interpret the parties' multistate agreement and by treating the extraterritorial application of the NJFPA merely as the consequence of CCC's agreement with a New Jersey-based distributor. But this Court, in applying the dormant Commerce Clause, has always focused on the "practical operation" of state statutes, *Lewis* v. *B.T. Inv. Mgrs., Inc.*, 447 U.S. 27, 37 (1980), and on their "practical effects." *Healy*, 491 U.S. at 336. Review by this Court is needed to make

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[12](...continued)
Maryland motor vehicle franchise statute that would have raised Commerce Clause concerns by penalizing out-of-state motor vehicle manufacturer for discontinuing operations in Maryland, since "'[t]he critical inquiry is whether the practical effect of the regulation is to control conduct beyond the boundaries of the State'") (quoting *Healy*, 491 U.S. at 336).

[12] *CSS-Wisconsin Office* v. *Houston Satellite Sys., Inc.*, 779 F. Supp. 979, 986 (E.D. Wis. 1991) ("because the distributor relationship between Consumer Satellite and Houston Satellite involves commerce that actually takes place in Wisconsin, the court is not persuaded that applying the Wisconsin Fair Dealership Law to the distributor relationship would offend the commerce clause"); *Diesel Service Co.* v. *Ambac Int'l Corp.*, 961 F.2d 635, 642 (7th Cir. 1992) (application of Wisconsin franchise law does not offend Commerce Clause when "at least one-third of the commerce took place within Wisconsin's borders").

clear that extraterritorial application of state law cannot be justified by the legal fiction that the court is enforcing the parties' own agreement—a theory that could just as easily be used to uphold other regulations forbidden by the Commerce Clause absent the consent of Congress.

1. The court of appeals sought to distinguish *Healy* on the basis that "it was the parties' own agreement," rather than the New Jersey legislature, "which operated to project the New Jersey law outside of New Jersey's borders." (26a) But this assertion is simply untrue. The agreement expressly provides that it will terminate after five years and that it is to be governed by California law. In dismissing ISI's common-law breach of contract claim, the district court held that the CCC-ISI 1984 Agreement is "clear and unambiguous" and that it expired on July 31, 1989. (230a)[20] The court of appeals affirmed this decision. Thus, any obligation on the part of CCC to continue distributing its products through ISI in the eight States after this date is solely the result of the NJFPA and the New Jersey Supreme Court's construction of the statute as having extraterritorial effect.

The state court applied the NJFPA to override the parties' agreement, and to force upon CCC the very kind of perpetual relationship that the parties in fact rejected, because of the "public policy" of the NJFPA and the intent of "the New Jersey Legislature." (107a, 129a) The New Jersey Supreme Court recognized that the extraterritorial application of the NJFPA was the product of "State power" (129a), not private contract: "[s]urely nothing indicates that CCC intended or agreed that the New Jersey law would cover its activities in the sister states of New Jersey." (128a-129a) The Third Circuit erred by ignoring the New Jersey

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[20] As the district court explained in granting summary judgment to CCC on the Commerce Clause issue, the "contract provided for application of California law and by its terms expired almost four years ago. . . . [W]hat [CCC] seeks to prevent is not the operation of its contract with ISI, but rather the State of New Jersey from superseding the contract to give ISI what may amount to a perpetual and exclusive right to distribute CCC's products in [the eight States]." (80a; internal quotation marks omitted).

Supreme Court's "authoritative" determination, *England*, 375 U.S. at 417, that the NJFPA applies extraterritorially and that the New Jersey legislature specifically intended such extraterritorial application.

2. The Third Circuit's conclusion that it was "the parties' own agreement" that produced extraterritorial regulation was therefore indefensible. So was the analysis that led the court to this untenable conclusion. The court of appeals reasoned that, since there is "nothing untoward" about applying one State's law to interpret a multistate contract, extraterritorial application of the NJFPA similarly presented no Commerce Clause issue. (25a) But it is fanciful to justify extraterritorial application of a regulatory statute like the NJFPA—one that mandates commercial behavior by government fiat—by analogy to rules of contract interpretation that honor the parties' agreement.

There is a fundamental difference between state laws that interpret a contract in order to enforce its terms, and statutes like the NJFPA that are exercises of state power imposing restrictions on out-of-state distribution contrary to the terms of the contract. Ordinarily, the former raise no Commerce Clause question because, by enforcing private agreements, they facilitate and indeed are vital to interstate commerce itself. But it does not follow that a state law overriding the parties' contract likewise raises no Commerce Clause concerns. On the contrary, state regulation that supersedes consensual agreements is precisely the kind of exercise of state power that is most likely to raise serious constitutional questions under the dormant Commerce Clause.

3. The Third Circuit also reasoned that CCC, not New Jersey, was responsible for the extraterritorial effects of the statute because it was CCC that chose to enter into a multistate distribution agreement with a New Jersey-based distributor. (*See* 26a). In substance, the Third Circuit said that extraterritorial regulation by New Jersey was inconsequential because it could have been avoided if CCC had simply forgone doing business on a multistate basis with ISI. But this reasoning begs the question of whether New Jersey had the power to put CCC to such a choice. It has long been

established, under the doctrine of unconstitutional conditions, that States do not have that power. Just as New Jersey could not forbid out-of-state suppliers from doing business with New Jersey-based distributors outright, so it cannot force out-of-state companies to choose between forgoing *interstate* business with New Jersey distributors and giving up their right, under the Commerce Clause, to be free from extraterritorial regulation. "[T]he power of the state [to place conditions on foreign corporations doing business in the State] is not unlimited; and one of the limitations is that it may not impose conditions which require the relinquishment of constitutional rights." *Western & Southern L.I. Co.* v. *Board of Equalization*, 451 U.S. 648, 664 (1981) (citation omitted); *see Garrity* v. *New Jersey*, 385 U.S. 493, 500 (1967) ("There are rights of constitutional stature whose exercise a State may not condition by the exaction of a price. Engaging in interstate commerce is one.").[21/]

The Third Circuit's reasoning is a blueprint for eviscerating the Commerce Clause. For example, under the Third Circuit's analysis, the brewers in *Healy* and the distillers in *Brown-Forman* could have avoided the out-of-state effects of the statute by "choosing" not to do business with Connecticut or New York wholesalers. The doctrine of unconstitutional conditions precludes the use of such fictions to destroy the protections of the Commerce Clause. It bears emphasis that these protections not only confer rights on CCC, *see Dennis* v. *Higgins*, 498 U.S. 439 (1991), but also are an essential structural safeguard preserving a federal economic union. It is therefore all the more important that the

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[21/] *See also Bendix Autolite Corp.* v. *Midwesco Enterprises, Inc.*, 486 U.S. 888, 893 (1988) ("The Ohio statutory scheme thus forces a foreign corporation to choose between exposure to the general jurisdiction of Ohio courts or forfeiture of the limitations defense, remaining subject to suit in Ohio in perpetuity.. . . The State may not withdraw [statute of limitations] defenses on conditions repugnant to the Commerce Clause. . . . The State may not condition the exercise of the defense on the waiver or relinquishment of rights that the foreign corporation would otherwise retain."); *Western Union Tel. Co.* v. *Kansas*, 216 U.S. 1, 47-48 (1910) (State may not condition right of out-of-state company to do business in the State upon company's submission to extraterritorial tax that violated Commerce Clause).

Commerce Clause not "be relegated to the status of a poor relation" in constitutional analysis. *Dolan* v. *City of Tigard*, 114 S. Ct. 2309, 2320 (1994).[22]

4. The Third Circuit's opinion may also be read as embracing the equally fallacious and dangerous fiction that CCC "agreed" to the extraterritorial application of the NJFPA because the prevailing law of New Jersey (including the NJFPA) can be presumed to be a part of any contract with a New Jersey-based distributor. This reasoning also begs the question, because the prevailing background law also includes the U.S. Constitution and any limitations it imposes on the extraterritorial application of the NJFPA. If the parties' contract is to be construed as having been executed against a legal background that included the NJFPA, it must be construed as having been formed against a background that included the Commerce Clause as well. This fiction also would nullify the Commerce Clause inasmuch as any commercial transaction could be said to take place against the background of existing state law.

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[22] To appreciate the radical nature of the Third Circuit's holding, it is useful to note that even in the context of the market-participant exception, where the Commerce Clause restriction on state activity is relaxed, this Court has never held that contractual conditions voluntarily agreed to by states and those with whom they do business are exempt from Commerce Clause scrutiny. In *South-Central Timber Development, Inc.* v. *Wunnicke*, 467 U.S. 82 (1984), for example, this Court struck down Alaska's attempt to require contractually that timber felled on state lands be processed within Alaska prior to export. Similarly, in *Wisconsin Dep't of Industry, Labor and Human Relations* v. *Gould, Inc.*, 475 U.S. 282 (1986), this Court held that a state could not use the market participant exception to refuse to enter into contracts with three-time violators of the National Labor Relations Act. The Court concluded that, "for all practical purposes, Wisconsin's debarment scheme is tantamount to regulation." *Id.* at 289. And in *Hicklin* v. *Orbeck*, 437 U.S. 518 (1978), this Court invalidated under the Privilege and Immunities Clause of Article IV a state law requiring companies engaged in the oil and gas business in Alaska to give preferences to state residents.

If the Constitution imposes such limits where the state is acting at the zenith of its powers—as a market participant or in regulating the use of its natural resources—*a fortiori* a state does not have the authority to require an out-of-state company, as a condition of its doing business within the state with a *private* entity, to accept whatever contractual terms the state imposes in the guise of "interpreting" the contract between the out-of-state company and the in-state entity.

Any burden on commerce could thus be dismissed as traceable to the parties' agreement rather than to action by the State.

For example, suppose the manufacturers and distributors in *Healy* or *Brown-Forman* had entered into a contract that was completely silent as to the relative position of in-state and out-of-state prices, but the State had a rule (labelled a rule of "contract interpretation" rather than a price-affirmation statute) specifying that whenever brewers or distillers enter into contracts with in-state distributors, an implied term of the contract is that the distributor will be charged prices no less favorable than those charged to distributors in neighboring States. Surely such a law would be invalid under the Commerce Clause for the same reasons as the laws struck down in *Healy* and *Brown-Forman*. But under the Third Circuit's approach, such a law would have to be upheld on the ground that, by entering into the agreement with the in-state distributors, the manufacturers "agreed" to the State's rule of contract law.

5. Equally dangerous in creating a blueprint for evasion was the Third Circuit's decision that the limitations of the Commerce Clause could be ignored here on the ground that only a "choice of law" question was involved. The New Jersey Supreme Court's "choice of law" ruling was based entirely on New Jersey's "strong policy in favor of protecting its franchisees," as reflected in the NJFPA, and more specifically on the court's reading of the New Jersey legislature's intention to protect New Jersey franchisees even when they operate outside the State. (106a-107a) Under the dormant Commerce Clause, the New Jersey legislature simply does not have the power to confer such extraterritorial protection, however styled or packaged. Putting a "choice of law" label on the State's exercise of power plainly cannot cure this defect. Indeed, the Third Circuit's reasoning is flatly inconsistent with a decision of the Seventh Circuit recognizing the distinction between the choice-of-law and Commerce Clause issues.[22] Review by this

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[22] In *Wright-Moore Corp.* v. *Ricoh Corp.*, 908 F.2d 128, 132-34 (7th Cir. 1990), the Seventh Circuit held that, under Indiana choice-of-law principles, the (continued...)

Court is urgently needed to make clear that the protections of the Commerce Clause may not be circumvented through such an artifice.

6. There is yet another reason that the court of appeals' decision warrants review: It runs afoul of the seminal principle of *Shelley* v. *Kraemer*, 334 U.S. 1, 19-20 (1948), that enforcement of state contract rules cannot be immunized from judicial scrutiny by treating the results of such enforcement as the product of the contracting parties' own agreement rather than of how the State's laws treat that agreement. In *Shelley* and subsequent cases, the Court has made clear that, even when courts are merely enforcing a private agreement, the effects of such state action must be tested for conformity with the Constitution. *Cohen* v. *Cowles Media Co.*, 501 U.S. 663, 668 (1991).[24] Yet the Third Circuit failed to perceive any state action implicating the Commerce Clause here even though New Jersey, far from enforcing the parties' own agreement, is creating a new agreement for them with enormous implications for the effective distribution of CCC's products in the entire Northeast region of the country.[25] The Third Circuit's

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[23](...continued)
Indiana franchise statute would apply to a multistate distribution agreement notwithstanding a New York choice-of-law clause. But the court of appeals observed that "[a]pplication of Indiana franchise law to control who sells [the supplier's products] in other states may present difficulties under the commerce clause" and that "[t]he import of the commerce clause on the application of Indiana law" required separate analysis. *Id.* at 134 n.2. On remand, the district court construed the statute as applying only within Indiana, in part because extraterritorial application would raise Commerce Clause difficulties. *Wright-Moore Corp.* v. *Ricoh Corp.*, 794 F. Supp. 844, 860-61 (N.D. Ind. 1991), *aff'd on other grounds*, 980 F.2d 432 (7th Cir. 1992).

[24] *See also Barrows* v. *Jackson*, 346 U.S. 249, 254 (1953); *Moose Lodge No. 107* v. *Irvis*, 407 U.S. 163, 172 (1972) ("the impetus for the forbidden discrimination need not originate with the State if it is state action that enforces privately originated discrimination").

[25] To say that judicial enforcement of contractual terms is state action *subject* to the Commerce Clause (contrast the Impairment of Contracts Clause, Art. I, (continued...)

holding that rewriting the parties' private agreement does not represent action by the State independently warrants review by this Court.

III. REVIEW IS INDEPENDENTLY WARRANTED BECAUSE THE THIRD CIRCUIT'S INSERTION OF A DISCRIMINATION REQUIREMENT INTO THIS COURT'S "*PIKE*" TEST CONFLICTS WITH *PIKE* ITSELF AND WITH THE LAW OF SEVERAL OTHER CIRCUITS

The court of appeals also upheld the extraterritorial application of the NJFPA under the *Pike* balancing test, but only by following a line of Third Circuit cases that have radically altered the *Pike* test and set a dangerous precedent that separately warrants review by this Court.

In keeping with the now-settled rule in the Third Circuit,[25] the court of appeals flatly refused even to *consider* as part of the burden on interstate commerce "the effect of the state regulation on the commerce of other states." (28a) The court held that "the *only* incidental burdens on interstate commerce that implicate the commerce clause . . . are those that discriminate against interstate

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[24](...continued)
§ 10, *see Tidal Oil Co.* v. *Flanagan*, 263 U.S. 444 (1924)), does not of course imply that such action is *unconstitutional*. In fact, state laws that construe or enforce contracts according to their terms—as distinct from laws that supersede those terms—would ordinarily pass muster quite easily under the Commerce Clause, for reasons that have already been explained. *See* p. 19, *supra*.

[25] *See, e.g.*, *Old Bridge Chemicals, Inc.* v. *New Jersey Dept. of Envtl. Protection*, 965 F.2d 1287, 1295 (3d Cir.) ("legislation will not be invalidated under the *Pike* test unless it imposes *discriminatory* burdens on interstate commerce") (emphasis in original), *cert. denied*, 113 S. Ct. 602 (1992); *J. Filiberto Sanitation, Inc.* v. *New Jersey Dept. of Envtl. Protection*, 857 F.2d 913, 922 (3d Cir. 1988) ("Once it is clear no such discrimination has been alleged, 'the inquiry as to the burden on interstate commerce should end'") (citation omitted); *Norfolk Southern Corp.* v. *Oberly*, 822 F.2d 388, 406 (3d Cir. 1987).

commerce." (28a; emphasis in original; citation omitted). And the court found that "there is no burden on interstate commerce inasmuch as the NJFPA is facially neutral as to the interstate nature of the parties' agreement." (29a) Under the court of appeals' analysis, it was therefore wholly irrelevant that application of the NJFPA out-of-state would "impose[] a straitjacket on [CCC's] operations and ultimately harm[] consumers by prohibiting the creation of an efficient distribution system" for delivery of goods in other States. (29a)

The Third Circuit rule and its application to this case are in direct conflict with *Edgar* v. *MITE Corp.*, 457 U.S. 624 (1982).In *MITE*, this Court invalidated an Illinois anti-takeover statute under the *Pike* test, even though it applied evenly to in-state and out-of-state transactions, and even though there was no allegation that the Illinois statute discriminated against interstate commerce. The Court struck down the statute entirely on the basis of the burdens it imposed on "out-of-state transactions." *Id.* at 644. The Third Circuit rule also conflicts with the decisions of many other Circuits.[21]

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[21] *First Circuit: Hyde Park Partners, L.P.* v. *Connolly*, 839 F.2d 837, 847-48 (1st Cir. 1988) (applying *Pike* test to affirm preliminary injunction against non-discriminatory state takeover statute, concluding that it unduly burdened commerce by reducing takeover bids and harming investors); *see also New Hampshire Auto. Dealers Ass'n, Inc.* v. *General Motors Corp.*, 801 F.2d 528, 532 (1st Cir. 1986) (Breyer, J.) (citing *Pike* and explaining that "these four factors—influencing the price of fleet sales transactions outside New Hampshire, limiting access by out-of-state manufacturers to New Hampshire consumers, limiting access by New Hampshire consumers to out-of-state sources of supply, and protecting New Hampshire retailers from outside competition—taken together suggest the possibility of a burden on commerce disproportionate to the interest the statute serves") (emphasis omitted).

Fourth Circuit: Medigen of Kentucky, Inc. v. *Public Service Comm'n*, 985 F.2d 164, 166-67 (4th Cir. 1993) (applying *Pike* to invalidate nondiscriminatory law requiring collectors, haulers, and transporters of infectious medical waste to obtain a certificate of convenience and necessity, and finding that "the burden that the certification requirement imposes on interstate commerce outweighs its local benefits").

Sixth Circuit: ANR Pipeline CO. v. *Schneidewind*, 801 F.2d 228, 237-

(continued...)

Regardless of whether individual Justices of this Court might, in a proper case, vote to alter or even abolish the *Pike* test, *see Bendix Autolite Corp.*, v. *Midwesco Enterprises, Inc.*, 486 U.S. 888, 897-98 (1988) (Scalia, J., concurring in judgment), the Third

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[11](...continued)

38 (6th Cir. 1986) (holding that nondiscriminatory state law requiring any natural gas utility to obtain advance approval from state public service commission before issuing securities, even if the proceeds would be used to finance a project in another State, violates *Pike* because "the burdens of expense, delay, and administrative hassle of 'advance approval' securities regulation far outweigh the benefits, if any," to the State), *aff'd on other grounds*, 485 U.S. 293 (1988).

Eighth Circuit: Pioneer Military Lending, Inc. v. *Manning*, 2 F.3d 280, 283 (8th Cir. 1993) (invalidating loan rules under *Pike*, because company "does business throughout the country . . . .[I]ts business would be adversely affected if it had to comply with differing state laws"; the burden that state "small loan laws would place on interstate commerce . . . is great compared to the relatively slight local interest served").

Ninth Circuit: NCAA v. *Miller*, 795 F. Supp. 1476, 1484 (D. Nev. 1992) ("A statute's effect beyond the enacting state's borders is also relevant in balancing the affected interests"), *aff'd*, 10 F.3d 633 (9th Cir. 1993); *BFI Medical Waste Sys., Inc.* v. *Whatcom County*, 756 F. Supp. 480, 486 (W.D. Wash. 1991) (holding that county's ban on importation of medical wastes would fail *Pike* test), *aff'd in relevant part, remanded in part*, 977 F.2d 587 (9th Cir. 1992).

Tenth Circuit: Dorrance v. *McCarthy*, 957 F.2d 761, 764 (10th Cir. 1992) (applying *Pike* test to assess the constitutionality of Wyoming's ban on the private ownership of big game animals, which applied equally to in-state and out-of-state residents, and specifically rejecting the Third Circuit's analysis: "Defendants contend that when a statute regulates evenhandedly, the extent of the burden the statute imposes on interstate commerce is irrelevant; the only inquiry is whether the statute imposes a different burden on interstate commerce than it does on intrastate commerce. Defendants' argument is not only circular, but it completely misstates the *Pike* analysis. By definition, a statute that regulates evenhandedly does not impose a different burden on interstate commerce than it does on intrastate commerce.").

Eleventh Circuit: Diamond Waste, Inc. v. *Monroe County*, 939 F.2d 941, 944-45 (11th Cir. 1991) (invalidating county ban on importation of out-of-county waste under *Pike*, even though "the resolution is applied relatively 'even-handedly' and accomplishes a 'legitimate local purpose,'" because "were other counties to adopt the same regulation in response, the impact on interstate commerce could be substantial").

See also Pacific Northwest Venison Producers v. *Baker*, 20 F.3d 1008, 1015 (9th Cir. 1994) (noting a conflict and indicating that decisions in the Second and Seventh Circuits follow the Third Circuit rule).

Circuit has no power to engage in any sort of pre-emptive overruling or modification of *Pike*. *See Rodriguez de Quijas* v. *Shearson/American Express, Inc.*, 490 U.S. 477, 484 (1989).

Moreover, the Third Circuit's imposition of a "discrimination" requirement in the *Pike* context is analytically insupportable and doctrinally unjustified. Discriminatory legislation is *per se* unconstitutional under the Commerce Clause without regard to *Pike*, which is designed for review of facially *neutral* legislation. By definition, the *Pike* test applies when "a statute has only indirect effects on interstate commerce and regulates *evenhandedly*." *Brown-Forman*, 476 U.S. at 579 (emphasis added). *See also C&A Carbone, Inc.* v. *Town of Clarkstown*, 114 S.Ct. 1677, 1689 (O'Connor, J., concurring) ("Even a nondiscriminatory regulation may nonetheless impose an excessive burden on interstate trade when considered in relation to the local benefits conferred") Indeed, this Court rejected the Third Circuit's approach over a century ago in *Brimmer* v. *Rebman*, 138 U.S. 78, 83 (1891) ("a burden imposed by a State upon interstate commerce is not to be sustained simply because the statute imposing it applies alike to the people of all the States, including the people of the State enacting such statute") (citation omitted). That fundamental principle of Commerce Clause jurisprudence has been repeatedly reaffirmed.[22]

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[22] *See Dean Milk Co.* v. *Madison*, 340 U.S. 349, 354 n.4 (1951) (finding it "immaterial that Wisconsin milk from outside the Madison area is subjected to the same proscription as that moving in interstate commerce"); *Fort Gratiot Sanitary Landfill, Inc.* v. *Michigan Dep't of Natural Resources*, 112 S. Ct. at 2025 (burden on in-state waste does not justify burden on out-of-state waste); *Bacchus Imports, Ltd.* v. *Dias*, 468 U.S. 263, 265, 271 (1984) (fact that some locally produced alcoholic beverages, together with out-of-state beverages, were denied special exemption from state liquor tax did not save it from being invalid).

CONCLUSION

This Court, and indeed the entire Federal Government, has a special role in preventing threats to the "Commerce Clause's central objective of securing a national 'area of free trade among the several States.'" *Associated Industries of Missouri* v. *Lohman*, 114 S. Ct. 1815, 1822 (1994) (citations omitted).[22] Review is urgently needed here to prevent the very real threat to the national economy posed both by the Third Circuit's decision and by the

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[22] "The United States has an interest in proper interpretation of the role of the Commerce Clause in our federal system . . . [and in] the free flow of commerce among the states and proper consideration of the prerogatives of the states." Brief for the Securities & Exchange Comm'n and the United States as *Amici Curiae*, *CTS Corp. v. Dynamics Corp. of Am.*, Nos. 86-71 & 86-97, Jan. 20, 1987, at 2. Accordingly, the United States has participated as an amicus at the merits stage in *CTS*, *MITE*, and several of the other recent Commerce Clause cases before the Supreme Court. *See, e.g.*, *Chemical Waste Management, Inc. v. Hunt*, 112 S. Ct. 2009 (1992).

blueprint it has provided for others to follow. The petition for writ of *certiorari* should be granted.

Respectfully submitted,

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December 9, 1994

(2)

Supreme Court, U.S.
FILED

941033 DEC 9 1994

OFFICE OF THE CLERK

No. ____

IN THE
Supreme Court of the United States

October Term, 1994

COMPUTER CURRICULUM CORPORATION,

Petitioner,

v.

INSTRUCTIONAL SYSTEMS, INC.
and
DEBORAH T. PORITZ, ATTORNEY GENERAL
OF THE STATE OF NEW JERSEY,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

APPENDIX TO PETITION FOR WRIT OF CERTIORARI

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APPENDIX A

Filed September 16, 1994

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 93-5414

INSTRUCTIONAL SYSTEMS, INC.,
a Corporation of the State of New Jersey

v.

COMPUTER CURRICULUM CORPORATION,
a Corporation of the State of Delaware

INSTRUCTIONAL SYSTEMS, INC.,

Appellant

DEBORAH T. PORITZ,*
Attorney General of New Jersey,

Intervenor
(per the Court's
Nov. 19, 1993 order)

No. 93-5490

INSTRUCTIONAL SYSTEM, INC.,
a Corporation of the State of New Jersey

v.

COMPUTER CURRICULUM CORPORATION,
a Corporation of the State of Delaware

v.

HON. ALFRED J. LECHNER, JR.,
United States District Judge
for the District of New Jersey,
Nominal Respondent

DEBORAH T. PORITZ,*
Attorney General of New Jersey,
Petitioner

No. 93-5635

INSTRUCTIONAL SYSTEM, INC.,
a Corporation of the State of New Jersey
Petitioner

v.

COMPUTER CURRICULUM CORPORATION,
a Corporation of the State of Delaware

HON. ALFRED J. LECHNER, JR.,
United States District Judge
for the District of New Jersey,
Nominal Respondent

No. 93-5722

INSTRUCTIONAL SYSTEM, INC.,
a Corporation of the State of New Jersey

v.

COMPUTER CURRICULUM CORPORATION,
a Corporation of the State of Delaware

INSTRUCTIONAL SYSTEMS, INC.,
Appellant

No. 94-5048

INSTRUCTIONAL SYSTEM, INC.,
a Corporation of the State of New Jersey

v.

COMPUTER CURRICULUM CORPORATION,
a Corporation of the State of Delaware

DEBORAH T. PORITZ,
Attorney General of New Jersey,
Intervenor in D.C.,
Appellant

On Appeal from the United States District Court
for the District of New Jersey
(D.C. Civ. No. 89-00502)

Argued July 11, 1994

Before: SLOVITER, *Chief Judge*, ROTH, *Circuit Judge*,
and POLLAK,** *District Judge*

(Filed September 16, 1994)

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* Caption amended pursuant to Fed. R. App. P. 43(c).

** Hon. Louis H. Pollak, United States District Judge for the Eastern District of Pennsylvania, sitting by designation.

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OPINION OF THE COURT

SLOVITER, *Chief Judge*.

In a far-reaching opinion, the district court limited the application of the New Jersey Franchise Practices Act to the activities of a New Jersey franchisee within New Jersey on the ground that giving the Act extraterritorial effect would conflict with the dormant Commerce Clause. Before we reach this issue of first impression, we must wind through the present status of the law on *Pullman* abstention and an *England* reservation.

I.

FACTS AND PROCEDURAL HISTORY

The relevant facts are not disputed. Computer Curriculum Corporation (CCC), a Delaware corporation headquartered in Palo Alto, California, produces and markets an integrated learning system that uses computer technology to teach and monitor a student's progress. Since 1975, Instructional Systems, Inc. (ISI), a New Jersey corporation,[1/] was CCC's exclusive distributor in the northeastern United States, subject to limited reservations by CCC. The parties entered into an agreement in 1984 that provided that ISI would be CCC's exclusive reseller in Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, Rhode Island, Vermont and Washington D.C., and that for its part ISI would sell only in those states and would deal only in CCC products. The Agreement provided that it would continue in effect until July 31, 1989. Finally, the Agreement provided that it "shall be construed and interpreted, and the legal relations created by it shall be determined, in accordance with the laws of the State of California." Jt. App. at 934.

[1/] Originally, CCC's arrangement was with ISI's predecessor, Educomp of New Jersey. The principal of both corporations was the same, Phyllis Kaminer.

As 1989 approached, CCC decided not to extend its relationship with ISI for the entire territory covered by the 1984 Agreement because, it claims, ISI was not aggressively marketing in some of the states. Instead, it offered ISI a two-year contract which limited ISI's market territory to New Jersey, New York and Massachusetts, thereby allowing CCC to distribute its products directly in the other (former ISI) states. ISI executed the 1989 Agreement under protest on January 30, 1989, and simultaneously filed its complaint in the Superior Court of New Jersey, Chancery Division.

The complaint contained seven counts. Count One alleged that the 1984 Agreement constituted a "franchise" for purposes of the New Jersey Franchise Practices Act ("NJFPA" or "Act"), N.J. Stat. Ann. § 56:10-3,[2] 10-4,[3] and that CCC violated the NJFPA by (a) failing to renew without good cause in violation of

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[2] Section 10–3(a) of the NJFPA defines a "franchise" as a:

> written arrangement for a definite or indefinite period, in which a person grants to another person a *license* to use a trade name, trade mark, service mark, or related characteristics, and in which there is a *community of interest* in the marketing of goods or services at wholesale, retail, by lease, agreement, or otherwise.

N.J. Stat. Ann. § 56:10–3(a) (West 1989) (emphasis added).

[3] Section 10–4 limits the scope of the NJFPA by providing that "[t]his act applies only to a franchise . . . the performance of which contemplates or requires the franchisee to establish or maintain a *place of business* within the State of New Jersey." N.J. Stat. Ann. § 56:10–4 (West 1989 & Supp. 1994) (emphasis added). The NJFPA defines a "place of business" as a "fixed geographical location at which the franchisee displays for sale and sells the franchisor's goods or offers for sale and sells the franchisor's services. Place of business shall not mean an office, a warehouse, a place of storage, a residence or a vehicle." *Id.* § 56:10–3(f).

Section 10–5,[4] and (b) attempting to impose unreasonable standards of performance upon ISI in the formation of the 1989 Agreement in violation of Section 10–7.[5] Counts Two through Seven alleged a variety of state common law claims.[6] As a remedy for each count, ISI sought an injunction restraining CCC from terminating its relationship with ISI and damages.

CCC removed the case to federal court on the basis of diversity of citizenship. In June 1989, following discovery, ISI moved for a preliminary injunction and partial summary judgment on the issue of whether the 1984 Agreement constituted a franchise agreement under the NJFPA. CCC opposed ISI's motions and filed a cross-motion for partial summary judgment, arguing that (1) California, not New Jersey, law applied to the 1984 Agreement; (2) application of the NJFPA to the franchise territory outside New Jersey would violate the dormant Commerce Clause; (3) the 1984 Agreement was not a franchise as defined by the NJFPA; and (4) CCC's actions were not in violation of the NJFPA. ISI

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[4] Section 10–5 of the NJFPA, which sets forth the requirements for the termination of a franchise, provides in part:

> It shall be a violation of this act for any franchisor to terminate, cancel or *fail to renew a franchise without good cause*. For the purposes of this act, good cause for terminating, canceling, or failing to renew a franchise shall be limited to failure by the franchisee to substantially comply with those requirements imposed upon him by the franchise.

N.J. Stat. Ann. § 56:10–5 (West 1989) (emphasis added).

[5] Section 10–7 of the NJFPA prohibits franchisors from "impos[ing] unreasonable standards of performance upon a franchisee." N.J. Stat. Ann. § 56:10–7(e) (West 1989).

[6] Specifically, Count Two alleged a breach of contract; Count Three, a breach of the implied covenant of good faith and fair dealing; Count Four, tortious interference with prospective economic advantage; Count Five, a breach of a covenant of non-competition; Count Six, unjust enrichment; and Count Seven, a breach of fiduciary duty.

responded by petitioning the district court to abstain pursuant to *Railroad Commission* v. *Pullman*, 312 U.S. 496 (1941), so that the NJFPA claim could be considered by the New Jersey courts.

The district court granted ISI's request for abstention over CCC's objection that the case could be resolved without reaching the constitutional questions raised by its motion for partial summary judgment. The court reasoned that "[i]f the New Jersey courts determine ISI does not fit within the definitional requirements of a franchise or that the Franchise Practices Acts is inapplicable to States other than New Jersey, then the need to address the commerce clause question in this matter will be eliminated." Jt. App. at 577.

ISI filed a suit for declaratory judgment in the New Jersey Superior Court, Chancery Division on July 27, 1989. After additional discovery, both parties moved for summary judgment. The court entered a declaratory judgment in favor of ISI, holding (1) that New Jersey law applied to the 1984 Agreement despite the choice-of-law provision of the Agreement; (2) that the 1984 Agreement was a "franchise" for purposes of the NJFPA, and (3) that the NJFPA applied even though the agreement encompassed a multistate territory. See *Instructional Sys., Inc.* v. *Computer Curriculum Corp.*, No. C-4116-89E (N.J. Super. Ct. Ch. Div. Oct. 30, 1989) *(ISI I)*. The Appellate Division of the Superior Court reversed, *see Instructional Sys., Inc.* v. *Computer Curriculum Corp.*, 578 A.2d 876 (N.J. Super. Ct. App. Div. 1990) *(ISI II)*, but the New Jersey Supreme Court reversed the Appellate Division and reinstated the judgment of the Chancery Division in October 1992, *see Instructional Sys., Inc.* v. *Computer Curriculum Corp.*, 614 A.2d 124 (N.J. 1992) *(ISI III)*.

The Supreme Court analyzed the issues before it in a series of questions. First, it decided what a franchise was under the NJFPA. Then it proceeded with the threshold choice-of-law question, holding that although "a close question," the trial court had not erred in applying New Jersey law because New Jersey has

a strong policy in favor of protecting its franchisees and because the franchisee is located in New Jersey, the majority of its employees reside in New Jersey, the investments relate primarily to assets in New Jersey, and the goodwill was developed for CCC by New Jersey residents. *Id.* at 135.

The Court then proceeded to determine whether the evidence was sufficient to find the statutory requirements for the existence of a franchise, which depended on whether ISI had a "place of business" in New Jersey, a "license," and a "community of interest" with CCC. Finding that these were all satisfied, *see id.* at 136–46, the Court then turned to the question whether the Act has "extraterritorial reach to the franchise activities in states other than New Jersey." *Id.* at 146. The Court reasoned that at its core, the NJFPA "is meant to deal with the unconscionable business practices affecting New Jersey franchises." *Id.* at 147, but that in meeting that purpose, the application of the Act did not stop at New Jersey's border. In its consideration of this issue, the Court discussed whether the application of New Jersey law in this manner would be consistent with the Commerce Clause. It reasoned that "New Jersey has no power, and therefore no interest, to regulate commerce that occurs entirely beyond its borders," but that this statute was regulating only "in-state conduct that has out-of-state effects." *Id.* at 146. The Court thus saw no unconstitutionality under the Commerce Clause or Due Process Clause "despite some incidental extraterritorial effects." *Id.* at 148.

The case then returned to the district court. CCC moved for partial summary judgment as to that portion of Count One that was based on application of the NJFPA outside of New Jersey. The district court gave notice of the attack on the constitutionality of the NJFPA to the Attorney General of New Jersey, *see* 28 U.S.C. § 2403(b) (1988), who chose to participate but did not formally intervene. On June 2, 1993, the district court granted CCC's motion for partial summary judgment as to the portion of Count One that sought to enjoin CCC from terminating ISI's franchise in states other than New Jersey. The district court's ruling was based

on its determination that application of the NJFPA outside New Jersey was a *per se* violation of the Commerce Clause. *See Instructional Sys., Inc.* v. *Computer Curriculum Corp.*, 826 F. Supp. 831. 848 (D.N.J. 1993) (*ISI IV*). ISI and the Attorney General appealed.[7]

CCC then moved for summary judgment on the six remaining common law claims as well as the remainder of Count One. The district court granted partial summary judgment on the common law claims on November 9, 1993, leaving for trial only that portion of Count One that which alleged that CCC has imposed unreasonable terms and conditions on ISI has imposed unreasonable terms and conditions on ISI in the 1989 Agreement as regards to New Jersey. *See Instructional Sys., Inc. v. Computer Curriculum Corp.*, No. 89-502(AJL) (D.N.J. Nov. 9, 1993) (*ISI V*). ISI appealed.[8]

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[7] On June 16, ISI petitioned the district court for certification of an interlocutory appeal under 28 U.S.C. § 1292(b), and the Attorney General asked for a certification under either Federal Rule of Civil Procedure 54(b) or § 1292(b) on June 18. ISI also filed a notice of appeal (docketed in this court as No. 93-5414) on July 2, arguing that this court had jurisdiction because the district court had denied its motion for an injunction. On July 22, the district court denied the parties' requests under § 1292(b) and Rule 54(b), reasoning that ISI's notice of appeal deprived it of jurisdiction to certify the order under either of the sections.

The Attorney General filed a petition for mandamus on August 12 (No. 93-5490) asking this court to order the district court to consider the certification requests, and a motions panel of this court remanded the case to the district court on September 20 "so that it may consider whether to grant motions for certification under 28 U.S.C. § 1292(b) or Fed. R. Civ. P. 54(b) free of its concern as to jurisdictional restraint by reason of the interlocutory appeal." Jt. App. at 1301. After the district court denied the motions on the merits on October 5, ISI filed a petition for mandamus on October 25 to vacate the June 2 district court order (No. 93-5635) and the Attorney General filed a supplemental petition for mandamus on November 10 seeking the same.

[8] ISI filed a notice of appeal on November 24, 1993 (No. 93-5722), claiming jurisdiction under 28 U.S.C. § 1292(a)(1). In mid-December CCC moved to certify the summary judgment orders as final under Rule 54(b). After ISI (continued...)

On appeal, this court granted the Attorney General's motion to intervene in No. 93-5414, and consolidated the five related appeals and petitions for disposition. We have jurisdiction over the appeals docketed at Nos. 93-5414, 93-5722 and 94-5048 pursuant to 28 U.S.C. § 1291 (1988).[2] Because the questions on appeal are legal, we exercise plenary review.

II.

DISCUSSION

A.

Abstention, Reservation and Preclusion

ISI contends that we are bound to accept not only the New Jersey Supreme Court's decision on the scope of the NJFPA and its application to its arrangement with CCC but also that Court's

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[1](...continued)
withdrew its opposition, the district judge to whom the case had been reassigned certified the summary judgment orders of June 2 and November 9 under Rule 54(b) on December 27. The Attorney General then filed a timely appeal from this order on January 25, 1994 (No. 94-5048). The remaining claim under the NJFPA, that the 1989 Agreement imposed unreasonable conditions of performance, was stayed pending the appeal.

[2] While there is some question whether we would have had jurisdiction over the appeals docketed at Nos. 93-5414 and 93-5722 because the action was still pending below and the orders may not have met the requirement laid out in *Carson v. American Brands, Inc.*, 450 U.S. 79, 83-84 (1981), the district court's certification of these orders as appealable under Rule 54(b) resolves this issue. We have held that even after a notice of appeal has been filed, a proper Rule 54(b) certification will cure any jurisdictional defect of a premature appeal. *See Feather v. United Mine Workers of America*, 711 F.2d 530, 535 (3d Cir. 1983). Since we have jurisdiction over all the district court's relevant orders to date, we will deny the petitions for mandamus in Nos. 93-5490 and 93-5635. *See Helstoski v. Meanor*, 442 U.S. 500, 506 (1979) (mandamus inappropriate when direct appeal immediately available).

conclusion that such an application did not violate the dormant Commerce Clause, as CCC had argued. CCC would limit not only the effect of the New Jersey courts' interpretation of the federal constitutional issue, but also their interpretation of the state law issues. These contentions require that we examine the circumstances surrounding the district court's *Pullman* abstention.

In deciding to abstain, the court stated that it was "remitt[ing]" to the state courts: "(a) Whether the Act has extraterritorial reach beyond the State of New Jersey ...; and (b) What are the definitions and standards of 'community of interest,' 'license' and 'place of business' under the Act?" Jt. App. at 587. It reserved to itself the "[a]pplication of the principles of law determined by the state court to the facts of this case"; "[a]ny constitutional challenge to the Act"; and "[a]ny application for injunctive or other interim relief." Jt. App. at 588. On ISI's request for clarification, the court explained that it expected the parties to file a declaratory judgment action. It recognized that to avoid giving an advisory opinion, the state court would have to look at the facts of this case in order to render its decision on the state law issues, but reiterated that it was maintaining fact-finding jurisdiction over the constitutional question.

Neither party presently challenges the propriety of abstaining *per se*.[19] However, the parties vigorously dispute the scope and effect of the district court's abstention.

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[19] No party took an appeal from the order abstaining and staying the federal proceedings. *See Hovsons Inc. v. Secretary of the Interior of the U.S.*, 711 F.2d 1208, 1211 (3d Cir. 1983) (the Court of Appeals has jurisdiction over appeal from district court's order to stay federal proceedings on *Pullman* grounds).

1.

Pullman Abstention

It is a general rule that "federal courts lack the authority to abstain from the exercise of jurisdiction that has been conferred." *New Orleans Pub. Serv., Inc.* v. *Council of New Orleans*, 491 U.S. 350, 358 (1989). There are a small number of "exceptional circumstances" which justify deviation from this rule. *See Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 14 (1983). "Abstention ... is the exception and not the rule. The federal courts' obligation to adjudicate claims within their jurisdiction is virtually unflagging." *Marks* v. *Stinson*, 19 F.3d 873, 881 (3d Cir. 1994) (quotations and citation omitted).

The abstention doctrine that stems from *Railroad Commission v. Pullman*, 312 U.S. 496 (1941), provides that "when a federal court is presented with both a federal constitutional issue and an unsettled issue of state law whose resolution might narrow or eliminate the federal constitutional question, abstention may be justified under principles of comity in order to avoid needless friction with state policies." *Marks*, 19 F.3d at 882 n.6 (quotation and citation omitted); *see also Chez Sez III Corp. v. Township of Union*, 945 F.2d 628, 631 (3d Cir. 1991) (describing three-step analysis of *Pullman* abstention), *cert. denied*, 112 S. Ct. 1265 (1992).

Pullman abstention is "virtually prohibited in diversity cases where the only difficulty is the unsettled posture of state law." *Urbano v. Board of Managers of N.J. State Prison*, 415 F.2d 247, 253 (3d Cir. 1969), *cert. denied*, 397 U.S. 948 (1970); *see also McNeese v. Board of Educ.*, 373 U.S. 668, 673 n.5 (1963); *Meredith v. Winter Haven*, 320 U.S. 228, 236 (1943). However, there are some situations for abstention even when the suit is brought under diversity jurisdiction. In *Clay v. Sun Insurance Office Ltd.*, 363 U.S. 207, 212 (1960), the Court held that abstention was appropriate in a diversity suit when the defendant

had raised doubts about the constitutionality of the statute relied upon by the plaintiff and the court "could not, on the available materials, make a confident guess how the [state] Supreme Court would construe the statute." Under these conditions, the Court found that abstention was justified "where a federal constitutional question might be mooted [by securing] ... an authoritative state court's determination of an unresolved question of its local law." *Id.*

This court has also recognized such a situation under precisely the same statute at issue here. In *Consumers Oil Corp. v. Phillips Petroleum Co.*, 488 F.2d 816, 819 (3d Cir. 1973), we held that abstention was appropriate in a diversity suit claiming a violation of the NJFPA because state law was unclear as to whether the Act applied to the agreement at issue and, if it did, "substantial constitutional questions" would need to be faced. *But see* Mariniello v. Shell Oil Co., 511 F.2d 853, 860-61 (3d Cir. 1975) (abstention inappropriate in adjudicating constitutional objections to New Jersey common law analog to the NJFPA).

2.

England Reservation

A party displaced from federal court under *Pullman* does not lose its right to a federal forum for all its claims. In *England v. Louisiana State of Board of Medical Examiners*, 375 U.S. 411 (1964), the Supreme Court was presented with a case in which the plaintiffs sued in federal court, were sent to the state courts under *Pullman* abstention, litigated all their claims there, lost, and then returned to federal court in an attempt to litigate their federal claims anew. Plaintiffs argued that they felt compelled to litigate their federal claims in state court by the Court's decision in *Government & Civic Employees Organizing Committee, CIO v. Windsor*, 353 U.S. 364, 366 (1957), which required parties remitted to the state courts under *Pullman* to inform those courts

what their federal claims were so that the state courts had the opportunity to construe the statute "in light of" those claims.

In *England*, the Court sought to balance the parties' rights to a federal forum with the federalism concerns inherent in rendering a constitutional judgment on an unclear state statute. It held that a party may preserve its right to return to federal court by making an express reservation in the state court that "he is exposing his federal claims there only for the purpose of complying with *Windsor*, and that he intends, should the state courts hold against him on the question of state law, to return to the District Court for disposition of his federal contentions." 375 U.S. at 421. Such a reservation of federal claims may be made by any party to the litigation. *See id.* at 422 n.13.

In this case it is clear that the federal question of whether the NJFPA could be constitutionally applied to the 1984 Agreement was explicitly reserved by CCC throughout the course of the state proceedings. Indeed, when the case was reactivated in the district court, it was ISI which submitted a letter to the district court that "concluded that the record supports CCC's contention that it entered a proper *England* reservation." Jt. App. at 1746.[11/]

[11/] While noting several times when CCC had discussed the issue, ISI stated that "[t]he record can be interpreted to indicate that CCC presented the constitutional issue to the state courts in order to inform those court of its existence, as required by *Windsor* and *England*. We have therefore concluded that CCC reserved its right to a determination by this Court of the federal constitutional issue." Jt. App. at 1747.

Although ISI now seeks to recant its conclusion,[12] it is clear from the record that CCC properly preserved its *England* reservation. At every stage of the state court proceedings, one party, if not both, stated that any constitutional questions were reserved for the district court and were being raised only to comply with the Supreme Court's *Windsor* decision.[13] We therefore reject

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[12] ISI claims for the first time in its brief in No. 93-5722 that its concession was "mistaken," and suggests that despite its waiver of the issue, because there was no valid reservation the district court lacks subject matter jurisdiction over the claim under the *Rooker-Feldman* doctrine. *See Port Auth. Police Benevolent Ass'n v. Port Auth.*, 973 F.2d 169, 177 (3d Cir. 1992) (*Rooker-Feldman* doctrine provides that "lower federal courts lack subject matter jurisdiction to engage in appellate review of state court determinations or to evaluate constitutional claims that are 'inextricably intertwined with the state court's [decision] in a judicial proceeding.'" (citation omitted)). It concedes that *Rooker-Feldman* does not apply if we find the *England* reservation to be properly preserved. *See Ivy Club v. Edwards*, 943 F.2d 270, 284 (3d Cir. 1991), *cert. denied*, 112 S. Ct. 1282 (1992). Because we do so find, we need not consider the effect of ISI's waiver.

[13] In the Chancery Division of the Superior Court, CCC expressly reserved its federal claims both at a hearing, Jt. App. at 1583-84, and in its brief, Supp. App. at 833-34. At the Appellate Division of the Superior Court, CCC noted that the district court had reserved jurisdiction to rule on any constitutional claims. Supp. App. at 1094. Its reference to the Commerce Clause was in the context of disputing the Chancery Division's statutory construction and arguing that interpreting the statute as the Chancery Division did would violate the Commerce Clause. Supp. App. at 1107-09.

The parties took the same position before the New Jersey Supreme Court. There was no dispute, as ISI noted in its submissions to the Supreme Court, that "the federal constitutional issue arising under the Commerce Clause ... is reserved for the federal court." Supp. App. at 1455; *see also* Supp. App. at 1461 n.2, 1492-93. CCC also made that point clear. Supp. App. at 1481.

Although CCC did mention the Commerce Clause issue in its merits brief, Supp. App. at 1543-44, it did so once again in the context of arguing that the Court should not construe the NJFPA to apply extraterritorially because that construction would impermissibly burden interstate commerce. At the original oral argument and on rehearing, CCC and ISI both noted at various times that the Commerce Clause question was reserved for the district court. Supp. App. at 1662, 1666,

(continued...)

ISI's claim that the fact that New Jersey Supreme Court discussed the Commerce Clause issue in rendering its decision about whether the Act applied extraterritorially, *see ISI III*, 614 A.2d at 146–48, precludes the federal courts' consideration of the issue, which was properly preserved.[14] As the Supreme Court noted in *England*, "the parties cannot prevent the state court from rendering a decision on the federal question if it chooses to do so." 375 U.S. at 241; *see also* 17A Charles A. Wright et al., *Federal Practice and Procedure* § 4243 (1988). It is the actions of the displaced litigant which are controlling and thus, after reviewing the parties' actions, we agree with the Attorney General that "the Commerce Clause issue did remain pending before the District Court, and the District Court was obligated to adjudicate it." Attorney General's Br. at 25.

ISI insists that even if CCC made a proper *England* reservation, we are bound by the factual findings and legal

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[13](...continued)
1837, and a member of the Court noted during the argument that "[t]he Commerce Clause issue is reserved." Supp. App. at 1807.

In post-argument briefs, ISI suggested for the first time that CCC violated the *England* command not to "affirmatively argue" the constitutional issue because CCC had discussed the Commerce Clause issue in its brief and at oral argument. Supp. App. at 1740–41. CCC responded that "CCC has merely informed the Court, for its assistance in construing the New Jersey statute, of the serious constitutional problem presented by ISI's construction." Supp. App. at 1772.

[14] *Parsons Steel, Inc. v. First Alabama Bank*, 474 U.S. 518 (1986), which ISI cites, is inapposite. In *Parsons*, the parties had concurrent actions pending in state and federal court regarding events arising out of the same conduct, the defendants first won in federal court, but the state court rejected the defenses of res judicata and collateral estoppel, and the defendants were found liable in that forum. The federal court then enjoined enforcement of the state court judgment because it determined that the state action was barred by res judicata. The Supreme Court held that the district court erred in failing to apply state preclusion law and remanded for a determination of whether the state court's resolution of the res judicata issue would be given preclusive effect in another court of the same state. It did not hold, as ISI implicitly suggests, that a state court's consideration of an issue precludes a federal court from doing so.

conclusions of the New Jersey courts by the full faith and credit statute, 28 U.S.C. § 1738 (1988), which requires that federal courts give "full faith and credit" to "judicial proceedings of any court of any State." It is true that a federal court is normally bound to extend preclusive effect to state proceedings to the same extent that courts of that state would do so. *See Migra v. Warren City School Dist. Bd. of Educ.*, 465 U.S. 75, 84 (1984); *Allen v. McCurry*, 449 U.S. 90, 99 (1980); *cf. Township of Washington v. Gould*, 189 A.2d 697, 700 (N.J. 1963) (declaratory judgments given preclusive effect under New Jersey law).

However, the Supreme Court noted in both those cases that when a party sought to adjudicate his claims in a federal forum and then was involuntarily remitted to state court, the party "can preserve his right to a federal forum for his federal claims by informing the state court of his intention to return to federal court on his federal claims following litigation of his state claims in state court." *Migra*, 465 U.S. at 85 n.7 (citing *England*); *see also Allen*, 449 U.S. at 101-02 n.17 (distinguishing *England* reservations as having "no bearing on the present case"). As we noted in *Kovats v. Rutgers*, 749 F.2d 1041, 1046 (3d Cir. 1984), "in its major preclusion decisions the [Supreme] Court has sought to distinguish the *England* situation." Thus the traditional rules of res judicata and collateral estoppel as applied by section 1738 do not apply to state proceedings that follow *Pullman* abstention and an *England* reservation. *See Bradley v. Pittsburgh Bd. of Educ.*, 913 F.2d 1064, 1072 (3d Cir. 1990) (claim preclusion does not apply to state court proceedings when proper *England* reservation made); *see also Fields v. Sarasota Manatee Airport Auth.*, 953 F.2d 1299, 1302 n.1, 1306 (11th Cir. 1992) (*Pullman/England* situation is an exception to full faith and credit requirements).

CCC argues that notwithstanding the *England* reservation, the New Jersey decisions are binding only on discrete facts found, i.e. the existence of a "place of business," "community of interest," and "license," but not on the ultimate facts, such as whether the relationship was a franchise under New Jersey law. It relies on the

emphasis given in *England* to federal fact-finding. *See* 375 U.S. at 416-17 ("How the facts are found will often dictate the decision of federal claims . . . [Therefore,] in cases where, but for the application of the abstention doctrine, the primary fact determination would have been by the District Court, a litigant may not be unwillingly deprived of that determination.").

We believe that the state law issues determined in the state court proceedings must be viewed as more than merely persuasive authority. We held in *Kovats* that a "state court's resolution of the state law question that required *Pullman* abstention clearly must be given some preclusive effect; otherwise abstention would be a meaningless procedure." 749 F.2d at 1046. The Supreme Court did not expect the state courts to issue abstract opinions of law, removed from the facts of the case, or resolve factual disputes only to have them treated as advisory opinions. Instead, the Court anticipated that the state court decision might resolve the suit entirely. *See England*, 375 U.S. at 421; *see also Phillips v. Pennsylvania Higher Educ. Assistance Agency*, 657 F.2d 554, 560 n.9 (3d Cir. 1981) (suggesting that state court decision under *Pullman* could definitively resolve the suit, even if resolution of legal issue was fact-intensive), *cert. denied*, 455 U.S. 924 (1982). Implicit in that assumption is the acknowledgement that the state courts will be rendering judgments based on a factual record.

While some states have certification provisions which may permit obtaining a state court's views on state law with only a sketchy factual content, *see* John B. Corr & Ira P. Robbins, *Interjurisdictional Certification and Choice of Law*, 41 Vand. L Rev. 411, 421-22 (1988), New Jersey is not such a state. In fact, New Jersey has expressed a strong policy against issuing advisory opinions. *See New Jersey Ass'n for Retarded Citizens, Inc. v. New Jersey Dep't of Human Servs.*, 445 A.2d 704,707 (N.J. 1982) ("We will not render advisory opinions or function in the abstract."); *Civil Serv. Comm'n v. State of New Jersey*, 397 A.2d 1098, 1101 (N.J. Super. Ct. App. Div.), *certif. denied*, 405 A.2d

811 (N.J. 1979); *Biegenwald v. Fauver*, 882 F.2d 748, 753 (3d Cir. 1989).

Thus, the judgment the parties have received from the New Jersey courts on the state law claims binds them, absent any federal impediment. This is so even in the rare *Pullman* abstention case such as this, where the state court must resolve factual disputes or engage in a totality-of-the-circumstances analysis in reaching its conclusions. In *Ivy Club v. Edwards*, 943 F.2d 270, 283 (3d Cir. 1991), *cert. denied*, 112 S. Ct. 1282 (1992), this court held that "[u]pon return to federal court [after *Pullman/England*], the federal plaintiff may fully litigate his federal claims, including the factual issues that may be identical to those underlying the state law question." However, in recognition of the nature of the state court proceedings as authoritative, we also held that "issue preclusion applies . . . to the state law question decided by the state court." *Id.*

This modified application of the preclusion doctrine to the state law claims is consistent with the policies underlying not only the full faith and credit statute, but also the Rules of Decisions Act 28 U.S.C. § 1652 (1988). The Rules of Decision Act, as interpreted by the Supreme Court in *Erie Railroad v. Tompkins*, 304 U.S. 64 (1938), and its progeny, requires as a matter of federalism that a federal court sitting in diversity attempt to apply state law as if it were a state court. In this case, for example, the district court needed to determine which state's law a New Jersey court would apply to the 1984 Agreement. *See Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487 (1941). A New Jersey court, in fact the highest New Jersey court, has definitively answered that question. As long as the parties had a full and fair opportunity to litigate the issue in the state proceeding, *cf. Kremer v. Chemical Constr. Corp.*, 456 U.S. 461, 481-82 (1982), it would offend all notions of comity and common sense to permit relitigation of that issue. Thus we hold that the New Jersey courts were entitled to resolve the state law issues presented in the context of the declaratory judgment suit (whether the parties' agreement was

covered by the NJFPA), and we are bound to accept their answer (yes), as well as the factual and legal findings necessary to that answer.

B.

Commerce Clause

We thus turn to the district court's holding that, accepting the New Jersey Supreme Court's decision that the 1984 Agreement was governed by the NJFPA, that statute violates the dormant Commerce Clause when applied to activities of a New Jersey franchise outside New Jersey.[15]

The Commerce Clause provides that "Congress shall have Power ... To regulate Commerce ... among the several States." U.S. Const., art. I, §8, cl. 3. The Supreme Court "long has recognized that this affirmative grant of authority to Congress also encompasses an implicit or 'dormant' limitation on the authority of the States to enact legislation affecting interstate commerce." *Healy v. Beer Institute*, 491 U.S. 324, 326 n.1 (1989).[16] The Commerce Clause reflects "the Constitution's special concern both with the maintenance of a national economic union unfettered by

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[15] CCC does not claim that New Jersey's choice-of-law holding itself violates the Commerce Clause and thus we do not reach that distinct question. *See* Harold W. Horowitz, Comment, *The Commerce Clause as a Limitation on State Choice-of-Law Doctrine*, 81 Harv. L. Rev. 806, 813-24 (1971).

[16] ISI seems to argue that if application of the NJFPA to the 1984 Agreement meets the requirements of due process, there can be no Commerce Clause problem. It is clear, however, that the "[l]ocal regulations which would pass muster under the Due Process Clause might nonetheless fail to survive other challenges to constitutionality that bring the Supremacy Clause into play. Like any local law that conflicts with federal regulatory measures, state regulations that run afoul of the policy of free trade reflected in the Commerce Clause must also bow." *Bibb v. Navajo Freight Lines*, 359 U.S. 520, 529 (1959) (citations omitted); *see also Quill Corp. v. North Dakota*, 112 S. Ct. 1904 (1992) (distinguishing application of due process and commerce clauses).

state-imposed limitations on interstate commerce and with the autonomy of the individual States within their respective spheres." *Id.* at 335-36.

The Supreme Court has articulated two tiers of scrutiny in analyzing statutes that regulate interstate commerce:

> When a state statute directly regulates or discriminates against interstate commerce, or when its effect is to favor in-state economic interests over out-of-state interests, we have generally struck down the statute without further inquiry. When, however, a statute only has indirect effects on interstate commerce and regulates evenhandedly, we have examined whether the State's interest is legitimate and whether the burden on interstate commerce clearly exceeds the local benefits.

Brown-Forman Distillers Corp. v. New York State Liquor Auth., 476 U.S. 573, 579 (1986) (citations omitted). In the end, the crucial consideration is "the overall effect of the statute on both local and interstate commerce." *Healy*, 491 U.S. at 337 n.14.

1.

Per Se Violations

"The principal objects of dormant Commerce Clause scrutiny are statutes that discriminate against interstate commerce." *CTS Corp. v. Dynamics Corp. of America*, 481 U.S. 69, 87 (1987). Such statutes are virtually *per se* invalid. *See C & A Carbone, Inc. v. Town of Clarkstown*, 114 S. Ct. 1677, 1683 (1994); *Philadelphia v. New Jersey*, 437 U.S. 617, 627-28 (1978). However, both parties agree that as the NJFPA does not differentiate between in-state and out-of-state franchisors, there is no discrimination against interstate commerce. Instead, the district court treated the statute as a "direct" regulation of interstate commerce.

CCC argues, and the district court agreed, that imposing the NJFPA upon a multistate contract is *per se* invalid because it has the practical effect of regulating extraterritorially.[12] The Supreme Court has noted on more than one occasion that "the Commerce Clause precludes the application of a state statute to commerce that takes place wholly outside of the State's borders, whether or not the commerce has effects within the State," and that the "critical inquiry is whether the practical effect of the regulation is to control conduct beyond the boundaries of the State." *Healy*, 491 U.S. at 336 (quotation and citations omitted); *see also Brown-Forman*, 476 U.S. at 582 ("Forcing a merchant to seek regulatory approval In one State before undertaking a transaction in another directly regulates interstate commerce."); *Edgar v. MITE Corp.*, 457 U.S. 624, 643 (1982) ("[A]ny attempt 'directly' to assert extraterritorial jurisdiction over persons or property would offend sister States and exceed the inherent limits of the State's power." (quotation and citation omitted); *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 521 (1935) ("New York has no power to project its legislation into Vermont by regulating the price to be paid in that state for milk acquired there."); *see also Old Bridge Chems., Inc. v. New Jersey Dep't of Envtl. Protection*, 965 F.2d 1287, 1293 (3d Cir.) ("The Supreme Court has invalidated state statutes where a state has 'projected' its legislation into other states and directly regulated commerce therein, thereby either forcing individuals to abandon commerce in other states or forcing other states to alter their regulations to conform with the conflicting legislation."), *cert. denied*, 113 S. Ct. 602 (1992).

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[12] At least one commentator has suggested that "extraterritoriality is not a dormant commerce clause problem" but acknowledges that the "[Supreme] Court has frequently treated extraterritorially, when it has arisen in the context of a dormant commerce clause case, as if it were a dormant commerce clause problem." Donald H. Regan, *Siamese Essays: (I) CTS Corp. v. Dynamics Corp. of America and Dormant Commerce Clause Doctrine; (II) Extraterritorial State Legislation*, 85 Mich. L. Rev. 1865, 1873 (1987).

The fact that application of the NJFPA is triggered by in-state activity does not in itself insulate it from scrutiny under the dormant Commerce Clause, for not all in-state activity is sufficient to justify a law which regulates out-of-state transactions of an interstate actor. *Compare Brown-Forman*, 476 U.S. at 580 ("The mere fact that the effects of New York's ABC Law are triggered only by sales of liquor within the State of New York ... does not validate the law if it regulates the out-of-state transactions of distillers who sell in-state.") and *MITE*, 457 U.S. at 641-42 (fact that corporation has some contacts with Illinois insufficient to permit Illinois to regulate its takeovers) *with CTS*, 481 U.S. at 93 (fact that corporation was incorporated in Indiana and has a substantial number of Indiana shareholders sufficient to permit Indiana to regulate its takeovers).

On the other hand, it is inevitable that a state's law, whether statutory or common law, will have extraterritorial effects. The Supreme Court has never suggested that the dormant Commerce Clause requires Balkanization, with each state's law stopping at the border. *See* Donald H. Regan, *Siamese Essays: (I)* CTS Corp. v. Dynamics Corp. of America *and Dormant Commerce Clause Doctrine; (II) Extraterritorial State Legislation*, 85 Mich. L. Rev. 1865, 1878 (1987) ("prohibition [of all state laws that have substantial extraterritorial effects] would invalidate much too much legislation."). In traditional contract litigation, courts must apply some state's law to interpret the contract. While a contract which covers multiple states may raise a difficult choice-of-law question, once that question is resolved there is nothing untoward about applying one state's law to the entire contract, even if it requires applying that state's law to activities outside the state.

CCC does not dispute this, but attempts to distinguish the NJFPA, a "state regulation," from an ordinary state contract rule. We see no basis for any such dichotomy. The construction of a contract, including the interpretive policies embodied in common law and statutory enactments, is no more or less regulatory than the

NJFPA, which imposes on franchises governed by New Jersey law certain provisions designed to promote fairness between the parties.

This is not to say that New Jersey would have a right to apply the NJFPA to any franchise agreement in the country, as long as suit is brought in New Jersey. But nothing in the text of the NJFPA reaches that far. Indeed, the New Jersey Supreme Court noted that "[b]y definition, the Act, and particularly its community-of-interest requirement, is intended to protect business parties who made a franchise-specific capital investment of either goods or services in New Jersey. Thus the statute's own terms ... will allow the application of the Act only in situations in which there are 'contacts' with the forum [and] 'interests' arising out of those contacts." *ISI III*, 614 A.2d at 148 (citation omitted); *see also* N.J. Stat. Ann. § 56:10-4 (West 1989 & Supp. 1994) (statute limits itself to franchises "the performance of which contemplates or requires the franchisee to establish or maintain a place of business within the State of New Jersey"). Furthermore, under generally accepted choice-of-law analysis, the courts measure whether New Jersey has sufficient interests with the franchise as to make it appropriate to apply the NJFPA.

In this case the record is clear that it was the parties, not New Jersey, who contemplated that the franchisee maintain a place of business in New Jersey. And it was the parties, not New Jersey, who bound themselves to an exclusive multistate distribution agreement. Therefore, it is the parties' own agreement which operated to project the New Jersey law outside of New Jersey's borders, a result which CCC will find ironic but which inevitably follows from the choice-of-law analysis.

This factor distinguishes this situation from the cases relied on by the district court. In those cases, the state laws that were held to burden interstate commerce operated independent of any party's agreement. In *Healy* and *Brown-Forman*, the states enacted price-affirmation statutes for beer and liquor, requiring suppliers to affirm that their prices in-state were no higher than the lowest price

they would charge for their product in border states. These laws were designed in such a way that a supplier's price in other states would be dependent on the prices it posted in the state enacting the regulation. However, in these cases it was the state, operating independently of any parties' contract, which dictated the extraterritorial effect. As noted, the situation here is distinguishable.

Of course, if the parties were subject to "inconsistent legislation" from different states, a law's "practical effect" might lead to a Commerce Clause violation. *See, e.g., Healy*, 491 U.S. at 336-37; *CTS*, 481 U.S. at 88-89; *Brown-Forman*, 476 U.S. at 582-83; *MITE*, 457 U.S. at 642-43. On the other hand, state laws which merely create additional, but not irreconcilable, obligations are not considered to be "inconsistent" for this purpose. *See Buzzard v. Roadrunner Trucking*, 966 F.2d 777, 784 n.9 (3d Cir. 1992).

In this case, there is no indication that any other state will impose demands on ISI or CCC which would require them to violate New Jersey law or vice versa. And while the laws of other states might permit CCC to conduct its franchise relationship with ISI under a different framework than that imposed by the NJFPA, that difference in approach by different states is not sufficient to require *per se* invalidation. *See Old Bridge Chems.*, 965 F.2d at 1293 (must show "actual conflict among state regulations" in order to demonstrate *per se* invalidity).

Thus the essence of CCC's objection, despite its assurance to the contrary, goes to New Jersey's decision on choice of law. Having accepted that decision, as we must, we see no facial conflict between the NJFPA and the dormant Commerce Clause.

2.

Pike Balancing

Because the district court decided the NJFPA was *per se* invalid, it never considered whether the NJFPA passes the balancing test enunciated in *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970). The Supreme Court has explained that where the statute addresses "a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." *Id.* at 142.[12]

Inasmuch as the parties argued the *Pike* balancing test in the district court and before us, we will consider whether, again looking at the NJFPA from a facial standpoint only, it fails to meet requisite balancing. In doing so we do not balance one state's interests against another, as ISI suggests we should, but rather we balance the state's interest against the burden on interstate commerce. *See MITE*, 457 U.S. at 643; *Aldens, Inc. v. Packel*, 524 F.2d 38, 45-50 (3d Cir. 1975), *cert. denied*, 425 U.S. 943 (1976).

Furthermore, contrary to CCC's argument, we do not look at the effect of the state regulation on the commerce of other states when we balance. Instead, "[u]nder this court's precedent, the *only* incidental burdens on interstate commerce that implicate the commerce clause ... are those that discriminate against interstate commerce. We have so held because the commerce clause is concerned with protectionism and the need for uniformity, and case

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[12] The Supreme Court has continued to recite, even if it has not applied, the *Pike* test as late as its last term, *see C & A Carbone, Inc. v. Town of Clarkstown*, 114 S. Ct. 1677, 1681 (1994); *Oregon Waste Sys., Inc. v. Department of Envtl. Quality*, 114 S. Ct. 1345, 1350 (1994), notwithstanding criticism of the *Pike* balancing by members of Supreme Court, *see, e.g., CTS*, 481 U.S. at 95-96 (Scalia, J., concurring) and commentators, *see* Donald H. Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 Mich. L. Rev. 1091, 1106-08 (1986).

law demonstrates that legislation will not be invalidated under the *Pike* test unless it imposes *discriminatory* burdens on interstate commerce.... Thus, where the burden on out-of-state interests rises no higher than that placed on competing in-state interests, it is a burden on *commerce* rather than a burden on *interstate* commerce." *Old Bridge Chems.*, 965 F.2d at 1295 (citations omitted, first emphasis added); *see also J. Filiberto Sanitation, Inc. v. New Jersey Dep't of Envtl. Protection*, 857 F.2d 913, 922 (3d Cir. 1988); *Norfolk Southern Corp. v. Oberly*, 822 F.2d 388, 406 (3d Cir. 1987).

As we explained in *Ford Motor Co. v. Insurance Comm'r*, 874 F.2d 926, 942-43 (3d Cir.), *cert. denied*, 493 U.S. 969 (1989), where we upheld a law prohibiting companies that were affiliated with savings and loan institutions anywhere in the country from selling insurance in Pennsylvania, the fact that a law may have "devastating economic consequences" on a particular interstate firm is not sufficient to rise to a Commerce Clause burden. *Id.* at 943. Instead, the inquiry requires that we examine whether the state law adversely affects *interstate* commerce. "[T]he focus [of the Supreme Court is on] ... the *manner* by which the statute regulated [and] ... the fact that the statute regulated *indiscriminately* compel[s] the conclusion that the Commerce Clause [has] not been violated." *Id.* at 944.

Applying this settled law, it is clear that there is no burden on interstate commerce inasmuch as the NJFPA is facially neutral as to the interstate nature of the parties' agreement. CCC claims the NJFPA imposes a straitjacket on its operations and ultimately harms consumers by prohibiting the creation of an efficient distribution system. But even assuming this to be true, it is indisputable that the statute simply does not differentiate between in-state and out-of-state franchisors. The limitation on termination of franchises to reasons of good cause is equally applicable to New Jersey-based franchisors as to those headquartered elsewhere. Thus, although the NJFPA may burden commerce, it creates no incidental burdens on interstate commerce for purposes of *Pike* balancing. "Once it is

clear no such discrimination has been alleged, the inquiry as to the burden on interstate commerce should end." *J. Filiberto*, 857 F.2d at 922 (quotations and citations omitted). In the absence of such a burden, an analysis of the "putative local benefits" of the NJFPA is unnecessary.[19]

In ISI's argument before this court, it expressly limited itself to the district court's facial analysis. It thus recognized that the New Jersey Supreme Court's holding did not purport to consider whether the NJFPA might, when applied, have a burdensome effect on interstate commerce. That issue, of course, could not be resolved as a matter of law, and indeed might have to await the interpretation given to the "good cause" provisions of the NJFPA. Although the Commerce Clause analysis and the Due Process analysis are distinct, *see supra* note 17, ISI's counsel recognized that there might be due process implications to certain interpretations of the NJFPA in the context of existing contracts.

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[19] Despite the district court's uncertainty about whether the New Jersey court's choice-of-law analysis was binding, the court applied New Jersey law when entering summary judgment for CCC on Counts Two through Seven. We have reviewed ISI's objections to the district court's reasoning and agree with the independent state law grounds articulated by the court.

The district court also entered summary judgment for CCC on the part of Count One which alleged that CCC "fail[ed] to renew a franchise without good cause" under § 10-5 of the NJFPA. *See* N.J. Stat. Ann. § 56:10-5 (West 1989). Both parties agree that there may be changes in a franchise agreement that are so significant that they amount to a constructive nonrenewal of the franchise. In this case, however, the district court based its holding that the 1989 Agreement was a "renewal" of the 1984 Agreement on its decision that the elimination of the territory of eight states followed from the Commerce Clause. *See ISI V*, *supra*, at 80 n.47. In light of our decision, we will reverse the entry of summary judgment on this ground as well to allow the district court to evaluate the nonrenewal claim anew.

That issue was not raised by CCC in its pleadings in this case,[20] and we consider it as beyond the scope of this appeal.

III.

CONCLUSION

For the foregoing reasons, we will deny the petitions for writs of mandamus docketed at Nos. 93-5490 and 93-5635; in the appeals docketed at Nos. 93-5414 and 94-5048, we will reverse the district court's judgment declaring the NJFPA unconstitutional as applied to activities of New Jersey franchisees outside of New Jersey and remand for further proceedings consistent with this opinion; and in the appeal docketed at No. 93-5722, we will affirm the district court's judgment for CCC on Counts Two through Seven, and reverse its judgment for CCC on the nonrenewal portion of Count One and remand for further proceedings consistent with this opinion. Costs in Nos. 93-5490, 93-5635, 93-5414 and 94-5048 to be assessed against CCC; costs in No. 93-5722 to be assessed against ISI.

A True Copy:
Teste:

Clerk of the United States Court of Appeals
for the Third District

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[20] The New Jersey Supreme Court's decision mentioned the due process clause, but we did not understand it to make a definitive ruling in that connection, and view that reference as part of its general discussion on the interpretation of the NJFPA.

NOT FOR PUBLICATION

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY
Civil Action No. 89-502 (AJL)

INSTRUCTIONAL SYSTEMS, INC.,

Plaintiff,

v.

COMPUTER CURRICULUM CORP.,

Defendant.

OPINION

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LECHNER, District Judge

Currently before the court is the motion of defendant Computer Curriculum Corp. ("CCC") for partial summary judgment pursuant to Fed. R. Civ. P. 56.[1/] The issue to be

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[1/] In support of its motion for partial summary judgment, CCC has submitted the following: Memorandum of Law in Support of Defendant Computer Curriculum Corporation's Motion for Partial Summary Judgment Based on the Commerce Clause (the "Moving Brief"); Affidavit of Sidney Rosdeitcher (the "Rosdeitcher Aff."); Affidavit of Ronald F. Fortune (the "Fortune Aff."); Statement of Material Facts Not in Dispute (the "CCC 12G Statement") (attached as Appendix to (continued...)

decided raises an important question of Federal constitutional interpretation. Specifically, it must be decided whether extraterritorial application of the New Jersey Franchise Practices Act (the "Franchise Practices Act"), N.J.S.A. §§ 56:10 *et. seq.*, violates the Commerce Clause of the United States Constitution (the "Commerce Clause"). U.S. Const. Art. I, § 8, cl. 3.

For the reasons that follow, the motion for partial summary judgment is granted. Extraterritorial application of the Franchise Practices Act, as described below, violates the Commerce Clause.

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[1]/(...continued)
Moving Brief); Reply Memorandum in Support of Defendant Computer Curriculum Corporation's Motion for Partial Summary Judgment Based on the Commerce Clause (the "Primary Reply Brief"); Defendant Computer Curriculum Corporation's Memorandum of Law in Reply to the Brief of Intervenor Attorney General of New Jersey (the "Secondary Reply Brief").

In opposition to the motion for partial summary judgment, plaintiff Instructional Systems, Inc. ("ISI") has submitted the following: Memorandum of Law of Plaintiff Instructional Systems, Inc. in Opposition to Defendant's Motion for Partial Summary Judgment Based on the Commerce Clause (the "ISI Opp. Brief"); Certification of Robert E. Rochford (the "Rochford Cert."); Statement of Material Facts Not in Dispute (the "ISI 12G Statement") (attached as Appendix to ISI Opp. Brief").

Also in opposition to the motion for partial summary judgment, the Attorney General of the State of New Jersey (the "Attorney General") has submitted the following: Brief of Intervenor Attorney General of New Jersey in Opposition to Motion for Summary Judgment (the "Attorney General Opp. Brief").

Oral argument was held on 10 May 1993.

Facts

A. The Parties and Their Relationship

CCC is a Delaware corporation with its principal place of business in Sunnyvale, California. CCC 12G Statement, ¶ 1; Moving Brief at 3. Since the mid-1970s, CCC has developed and produced computer software, hardware and other products known as integrated learning systems (the "Integrated Learning Systems").[2] CCC 12G Statement, ¶ 2; Declaration of Patrick Suppes (the "Suppes Decl."), ¶ 2 (attached as Exhibit A to Rosdeitcher Aff.). CCC sells the Integrated Learning Systems to purchasers located throughout the United States. CCC 12G Statement, ¶ 2. School districts are the primary purchasers of Integrated Learning Systems. Suppes Decl., ¶ 2.

ISI is a New Jersey corporation with its sole place of business in Hackensack, New Jersey. ISI 12G Statement, ¶ 1. All of ISI's sales force and consultants work out of ISI's New Jersey facility. Certification of Phyllis Kaminer (the "Kaminer Cert."), ¶ 13 (attached as Exhibit 2 to Rochford Cert.). Since 1974, ISI has been the exclusive re-seller of CCC products, including Integrated Learning Systems, in the northeast United States.[3] ISI 12G Statement, ¶ 2; Suppes Decl., ¶ 4. In this regard, the parties

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[2] CCC describes its Integrated Learning Systems as follows:

> [Integrated Learning Systems are] a method of using computers to assist in education. CCC's software, or "courseware," is used to help students from kindergarten through grade 12, as well as adults, improve their skills in math, reading, science and other subjects.

Moving Brief at 3-4; *see also* Suppes Decl., ¶ 2.

[3] Specifically, ISI's marketing territory (the "Marketing Territory") consisted of Connecticut, Delaware, the District of Columbia, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island and Vermont. CCC 12G Statement, ¶ 3.

entered into a series of written contracts, each for a definite term.[4]

As a re-seller of CCC products, ISI purchased and licensed those products from CCC and, in turn, sold and sublicensed those products to end-users in the Marketing Territory. ISI 12G Statement, ¶ 4. According to ISI, "[a]t all times, the end users were customers of ISI and had no direct relationship with CCC." ISI 12G Statement, ¶ 4. It appears ISI does not and has not "paid a franchise fee or fee of any kind to be a reseller of CCC's products." Suppes Decl., ¶ 4. Moreover, ISI conducts its business under its own name, rather than CCC's. *Id.*, ¶ 7. Neither CCC's

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[4] CCC asserts that, early in its relationship with ISI, it declined a proposal that ISI be given a "perpetual distributorship." Moving Brief at 5; Fortune Aff., ¶ 12; Suppes Decl., ¶ 5. According to CCC, a series of temporally finite contracts were preferable because "[t]he computer industry is very dynamic." Moving Brief at 5; Fortune Aff., ¶ 12. In fact, CCC states that the Integrated Learning Systems industry "ha[s] undergone a dramatic transformation" in recent years. Moving Brief at 5; *see also* Fortune Aff., ¶ 2. CCC states:

> What was [in the 1970s] a relatively obscure group of small start-up firms is now a rapidly growing, highly competitive $300 million business that has attracted the attention of Fortune 500 companies. Jostens, a publicly held company that has entered the I[ntegrated] L[earning] S[ystems] business in 1986, has surpassed CCC in terms of sales revenues and last year acquired the third-largest I[ntegrated] L[earning] S[ystems] firm. Several other competitors, including IBM, have also emerged. CCC itself was acquired in 1990 by Simon & Schuster, Inc. The business also has expanded into segments, such as job training for business, industry and correctional institutions.

Moving Brief at 5 n.4 (citations omitted); *see also* Fortune Aff., ¶¶ 2-15 (discussing increase in sales and change in market of Integrated Learning Systems). It is predicted that by 1996, sales of Integrated Learning Systems will reach $750 million annually. Fortune Aff., ¶ 3 (citing *Electronic Media For the School Market: Review, Trends & Forecast* (1992)). ISI concedes that competition in the Integrated Learning Systems business has "become much more intense." Kaminer Cert., ¶ 60.

name nor logo appears on ISI's stationary or business cards. *Id.* From 1985 through 1989, sales of CCC's products constituted 97 percent of ISI's total sales revenues. Kaminer Cert., ¶ 80.

On 12 July 1984, CCC and ISI entered into an agreement (the "1984 Agreement") appointing ISI as the exclusive re-seller of certain CCC products, including Integrated Learning Systems, in the Marketing Territory. CCC 12G Statement, ¶ 3; *see* 1984 Agreement, ¶ 2.01 (attached as Exhibit H to Rosdeitcher Aff.). By its own terms, the 1984 Agreement was to expire on 31 July 1989. CCC 12G Statement, ¶ 4; 1984 Agreement, ¶ 13.01. Construction of the 1984 Agreement, as well as any legal relations which it created, was to be governed by California State law. CCC 12G Statement, ¶ 4; 1984 Agreement, ¶ 14.10. The 1984 Agreement contained no provision requiring renewal beyond the expiration date.

The 1984 Agreement required ISI to "use its best efforts to promote demand for and to [r]e-sell [CCC's p]roducts to the [m]arket within the Territory," to "maintain adequate facilities for such purposes"[2] and to "employ no less than four full-time sales representatives to accomplish this purpose." 1984 Agreement, ¶ 6.01; ISI 12G Statement, ¶¶ 2, 5. Moreover, in order to qualify for certain discounts on CCC products, the 1984 Agreement required ISI to adhere to a sales quota for the Marketing Territory

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[2] ISI contends it was required by CCC to maintain an office in New Jersey. ISI 12G Statement, ¶ 5. According to CCC, however, "ISI's location in New Jersey is purely ISI's decision. There is no function ISI has performed in New Jersey it could not perform elsewhere." Suppes Decl., ¶ 4. In fact, the 1984 Agreement does not appear to require ISI to maintain a place of business in any specific state. *See* 1984 Agreement, ¶ 6.01.

as a whole.[6] ISI 12G Statement, ¶ 5; Suppes Decl., ¶ 9; 1984 Agreement, ¶¶ 4.02-4.03.

In return, the 1984 Agreement granted certain software and hardware user licenses to ISI and authorized ISI "to use CCC's name, trademark and logo in its advertising, trade shows, public relations materials and manuals." 1984 Agreement, ¶¶ 3.01-3.03, 6.02. It was expressly provided that these licenses and rights terminated upon expiration of the 1984 Agreement. *Id.* ¶¶ 3.04, 6.02. Moreover, the 1984 Agreement expressly stated that "ISI shall not enjoy any rights in the CCC name, its trademarks or logo." *Id.*, ¶ 6.03; *see also id.*, ¶¶ 11.01-11.02.

CCC asserts that, during the course of the 1984 Agreement, it met with ISI and "expressed concern with ISI's performance and ability to compete" in the Marketing Territory.[7] Moving Brief at 6; *see also* Suppes Decl., ¶¶ 8, 10. CCC perceived that ISI was concentrating its sales efforts in three states—New York, New Jersey and Massachusetts—and not adequately serving the seven other states and the District of Columbia (the "Eight States") within the Marketing Territory.[8] Moving Brief at 6; Suppes Decl., ¶ 8;

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[6] CCC explains this quota/discount system as follows:

> ISI has always had discounts based upon meeting certain quotas. In other words, the greater the sales volume, the greater the discount. This is a common method of pricing with respect to distributors within the computer industry. Distributors are compensated by discounts off the suggested retail price for the equipment.

Suppes Decl., ¶ 9.

[7] ISI asserts that CCC expressed no dissatisfaction until 1988. Kaminer Cert., ¶¶ 66-67.

[8] ISI maintains that, prior to this time, ISI's performance had always been judged on the total amount of revenues generated from the Marketing Territory as a whole, rather than on an individual state-by-state basis. Kaminer Cert., ¶ 67.

see also Letter, dated 14 January 1988, from CCC to ISI (discussing uneven marketing efforts of ISI) (attached as Exhibit D to Rosdeitcher Aff.); Letter, dated 24 June 1988, from CCC to ISI (same) (attached as Exhibit E to Rosdeitcher Aff.).

CCC states: "ISI was doing little or no business in ... Connecticut, Delaware, the District of Columbia, Maine, Maryland, New Hampshire, Rhode Island and Vermont." Moving Brief at 6. For instance, it appears ISI made no sales in New Hampshire or Vermont from 1981 to 1989.[9] Moving Brief at 6; Deposition Transcript of Phyllis Kaminer ("Kaminer Dep. Tr."), dated 9 May 1989, 315–16 (attached as Exhibit B to Rosdeitcher Aff.). Over the same nine-year period, ISI made only two sales in Maine. Kaminer Dep. Tr. at 316.

Allegedly based upon ISI's performance, CCC determined that decreasing the area of the Marketing Territory was necessary. Suppes Decl., ¶¶ 8–14. According to CCC:

> By neglecting parts of the [Marketing T]erritory, ISI was irretrievably damaging CCC. Competition is strong in the [I]ntegrated [L]earning [S]ystems business, and once a competitor's system is installed in a particular school district, the district is not likely to switch to CCC's system.[10] CCC's

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[9] According to CCC, "[a]lthough the [E]ight states included approximately 30 [percent] of the students within [the Marketing T]erritory, they accounted for only 11 [percent] of ISI's sales revenues to CCC from 1985 through 1987." Moving Brief at 6; *see also* Suppes Decl., ¶ 8.

[10] ISI concedes this point:

> In fact, it is true that once any [I]ntegrated [L]earning [S]ystem has been installed, a switch by a customer to another [I]ntegrated [L]earning [S]ystem is extremely unlikely to occur, particularly for several years after the initial installation

(continued...)

> economic interests and its ability to effectively market its products [were] threatened by ISI's failure to market the disputed states.... There [wa]s no justification for CCC to continue to remain a passive observer while its competitors make inroads into the states ISI ha[d] largely ignored.

Suppes Decl., ¶ 10.

In opposition, ISI explains that, in the latter part of 1988, its representatives met with CCC personnel to explain the reason for this disparity in sales. ISI states:

> [ISI] presented [CCC] with documentary evidence showing that the states with which [CCC] was concerned were either being significantly marketed by ISI and/or that there were factors ... which made it difficult to penetrate those states with respect to sales of [I]ntegrated [L]earning [S]ystems. These factors include the high percentage of small school districts in these states, the relative paucity of entitlement funds to purchase [I]ntegrated [L]earning [S]ystems, resistance of educators and taxing authorities to expenditure of funds in these smaller states, increased telephone charges in these smaller states which cause a disproportionate expense for the use of [I][ntegrated [L]earning [S]ystems and various similar factors.

Kaminer Cert., ¶ 68.

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[10](...continued)
of the system.

Supplemental Certification of Phyllis Kaminer, ¶ 2 (attached as Exhibit 3 to Rochford Cert.).

CCC recounts that, in July 1988, its dissatisfaction with ISI's performance led CCC to (1) inform ISI that it desired to begin direct marketing of CCC products in the Eight States and (2) offer ISI a new exclusive distribution contract limiting ISI's Marketing Territory to New York, New Jersey and Massachusetts.[11] Moving Brief at 6–7. CCC emphasizes that it "intended to take over personally the marketing of its products" in the Eight States.[12] Suppes Decl., ¶ 8.

On 30 January 1989, ISI signed a new re-seller agreement (the "1989 Agreement") which limited its Marketing Territory to New York, New Jersey and Massachusetts.[13] Moving Brief at 7; *see also* 1989 Agreement, ¶ 1.10 (attached as Exhibit I to Rosdeitcher Aff.). On that same day, 30 January 1989, ISI filed this lawsuit.[14] *See* Complaint (the "Complaint"), filed 30 January 1989.

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[11] CCC states that it "gave serious consideration to letting CCC's agreement with ISI to lapse entirely when the [1984 Agreement] expired." Suppes Decl., ¶ 8.

[12] It appears that this is not the first time that ISI Marketing Territory has been changed. For example, CCC indicates:

> [T]he Eastern Pennsylvania area was within ISI's territory. Subsequently, this territory was removed. At an earlier time, ISI did not have the State of Maryland or the District of Columbia within its territory; this was later added.

Suppes Decl., ¶ 6. CCC states that, prior to this litigation, ISI never claimed that its distributorship of CCC products was made in perpetuity. *Id.* ¶ 5.

[13] Nevertheless, it appears that, at least for 1989, ISI continued and enhanced its sales activities in the Eight States. *See* Kaminer Cert., ¶¶ 70-71.

[14] The Complaint was filed in the Superior Court of New Jersey, Chancery Division, Passaic County. *See* Complaint at 1. On 6 February 1989, the case was removed to this court pursuant to 28 U.S.C. § 1441. *See* Notice of Removal, filed 6 February 1989, at 1. Jurisdiction is alleged pursuant to 28 U.S.C. § 1332. *Id.*

B. The Complaint

The Complaint alleges that, although the 1984 Agreement contained a specific expiration date, it was "always understood that the relationship between [ISI and CCC] would not be terminated except for good cause." Complaint, ¶¶ 14, 18. The Complaint further alleges that, consistent with the 1984 Agreement, "ISI has fully and completely complied with the requirements of its arrangements with CCC and has successfully utilized its best efforts to develop a demand for CCC's products in the geographical area assigned to it." *Id.* ¶ 24.

According to ISI, it signed the 1989 Agreement "[u]nder business duress created by CCC, and without waiving its rights to test the legality of the [1989 Agreement]." *Id.*, ¶ 41. ISI describes this alleged business duress as follows:

> CCC ... demanded that ISI sign the [1989 Agreement] and deliver it to CCC by January 31, 1989, together with certain ISI financial statements and the personal guarantee of [ISI's principal] Phyllis Kaminer. If ISI [did] not, CCC ... threatened to revoke its offer and begin immediately to make alternate marketing arrangements to distribute its [p]roducts in New Jersey, New York and Massachusetts.
>
> CCC ... refused to enter into any meaningful negotiation to change or alter the terms of the proposed contract....
>
> The offer of the [1989 Agreement] by CCC, CCC's refusal to negotiate any of its terms and the ultimatum basis on which it was presented are part of CCC's deliberate and intentional plan to destroy ISI and its business and appropriate the goodwill

> and property rights that ISI has created for itself in its territory since 1974....
>
> In furtherance of this plan to destroy ISI, CCC ... refused to provide ISI with any necessary technical, pricing and discount information with respect to the new IBM CCC hardware program now being offered ... unless and until ISI execute[d] and deliver[ed] the [1989 Agreement] without change by ISI, together with the requisite financial information.

Id., ¶¶ 36-37, 39-40; *see also* Kaminer Cert., ¶¶ 68-69.

ISI alleges, *inter alia*, that the 1984 Agreement constitutes a franchise under New Jersey Law, as defined in N.J.S.A. § 56:10-3(a). Complaint, ¶ 32. ISI further alleges that CCC's actions with respect to the 1989 Agreement—namely, failing to renew the 1984 Agreement without good cause and "attempting to impose unreasonable standards of performance upon ISI"—violate the Franchise Practices Act, N.J.S.A. §§ 56:10-5 and 56:10-7 (the "Franchise Practices Act Claim").[12] *See* Complaint, ¶ 14. ISI seeks injunctive relief "restraining CCC from terminating its relationship with ISI as substantially set forth in the [1984] Agreement." *Id.*, ¶ 44(a). ISI also seeks damages and a declaration of ISI's and CCC's rights under their relationship. *Id.*, ¶ 44(b), (d).

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[12] The Complaint also sets forth six additional counts alleging breach of contract, breach of implied covenant of good faith and fair dealing, tortious interference with respect to economic advantage, unfair competition, unjust enrichment and breach of fiduciary relationship. Complaint, ¶¶ 45-66.

C. The Franchise Practices Act Claim

Section 10-3(a) of the Franchise Practices Act, N.J.S.A. § 56:10-3(a) defines "franchise" as follows:

> [A] written arrangement for a definite or indefinite period, in which a person grants to another person a license to use a trade name, trade mark, service mark, or related characteristics, and in which there is a community of interest in the marketing of goods or services at wholesale, retail, by lease, agreement, or otherwise.

Id.

Section 10-5 of the Franchise Practices Act, N.J.S.A. § 56:10-5, sets forth exacting requirements for the termination of a franchise defined under the Act. Section 10-5 provides in pertinent part:

> It shall be a violation of this act for any franchisor directly or indirectly through any officer, agent, or employee to terminate, cancel or *fail to renew* a franchise without having first given written notice setting forth all the reasons for such termination, cancellation, or intent not to renew to the franchise at least 60 days in advance of such termination, cancellation, or failure to renew.... It shall [also] be a violation of this act for a franchisor to terminate, cancel or *fail to renew* a franchise *without good cause*. For the purposes of this act, good cause for terminating, canceling, or failing to renew a franchise shall be limited to failure by the franchisee to *substantially comply* with those requirements imposed upon him by the franchise.

N.J.S.A. § 56:10-5 (emphasis added).

As the Third Circuit has stated, this section of the Franchise Practices Act creates "an exception to the general rule that two businesses are free to terminate their business relationship according to the terms of their contract." *New Jersey Am., Inc.* v. *Allied Corp.*, 875 F.2d 58, 61 (3d Cir. 1989). Moreover, "good cause" for termination does not include bona fide business reasons for discontinuing the franchise relationship. *See Westfield Centre Serv., Inc.* v. *Cities Serv. Oil Co.*, 86 N.J. 453, 465–66 (1981).

Finally, Section 10–7 of the Franchise Practices Act, N.J.S.A. § 56:10–7, prohibits certain practices by franchisors. Specifically, pursuant to Section 10–7(e), it is a violation of the Franchise Practices Act for any franchisor "to impose unreasonable standards of performance upon a franchisee." *Id.*, § 56:10–7(e).

D. Procedural History

In June 1989, ISI moved for a preliminary injunction to prevent the 1989 Agreement from taking effect such that the Marketing Territory would be curtailed to three states. Opp. Brief at 8–9. CCC opposed the motion for preliminary injunction and cross-moved for partial summary judgment on the Franchise Practices Act Claims. *Id.* at 9. In support of its cross-motion for partial summary judgment, CCC argued that applying the Franchise Practices Act to this case would be an unconstitutional restraint on interstate commerce (the "Commerce Clause Argument"). *See* Memorandum of Points and Authorities in Opposition to the Application for Preliminary Injunction and Motion for Partial Summary Judgment, 12 (citing *Healy* v. *Beer Instit.*, 491 U.S. 324 (1988)).

In response to the Commerce Clause Argument posed by CCC, ISI moved to have this court abstain and remand the Franchise Practices Act issues in this case to the New Jersey Superior Court, to afford the New Jersey state courts a fair opportunity to decide those issues, pursuant to *Railroad Comm'n of Texas* v. *Pullman Co.*, 312 U.S. 496 (1941).

By an opinion, filed 20 July 1989 (the "20 July 1989 Decision"), the ISI motion for abstention was granted. 20 July 1989 Decision at 3. It was stated:

> The threshold issue in this case is necessarily whether ISI has properly invoked the Franchise Practices Act. Before a court may legitimately consider whether ISI is a franchise[e] within the meaning of the [Franchise Practices A]ct and was terminated for good cause, it must ascertain whether the [Franchise Practices A]ct applies as suggested by ISI.... [A] court should not work through the mechanics of a statute not properly placed before it.... Only by abstaining at this time and affording the courts of New Jersey a fair opportunity to provide a definitive interpretation of Franchise Practices Act will judicial resources be expended wisely.

Id. at 13.

Accordingly, Count One of the Complaint—the Franchise Practices Act Claim—was remanded to state court. *Id.* at 16. Specifically, the following issues were identified for resolution by the New Jersey State courts: (l) Whether the Franchise Practices Act has extraterritorial reach beyond the State of New Jersey and, if so, to what extent and (2) what are the definitions and standards of "community of interest," "license" and "place of business" under the Franchise Practices Act. Order, filed 27 July 1989 (the "27 July 1989 Order") at 1. The 27 July 1989 Order was subsequently clarified to allow the New Jersey State courts to also determine (1) whether there is a "community of interest" between ISI and CCC and (2) whether ISI has a "place of business" within the meaning of the Franchise Practices Act.

The remaining counts of the Complaint were administratively terminated pending the state court resolution of the Franchise

Practices Act Claim. *Id.* at 1-2. Jurisdiction was retained to apply the law established by the New Jersey courts to the facts of this case, to resolve any constitutional challenge to the Franchise Practices Act and to determine any application for injunctive relief. *Id.*

E. Resolution of the Franchise Practices Act By the New Jersey Supreme Court

In *Instructional Systems, Inc.* v. *Computer Curriculum Corp.*, 130 N.J. 324 (1992), after three years of post-remand proceedings, the New Jersey Supreme Court reached a decision on the remanded issues.

The New Jersey Supreme Court determined the relationship between ISI and CCC contained all the elements necessary to constitute a franchise within the meaning of the Franchise Practices Act.[19] First, the court found that "[t]here was sufficient evidence to support a finding of fact that the 1984 Agreement 'contemplated' that ISI would have a 'fixed business location' in New Jersey." *Id.* at 348-51.

Second, the New Jersey Supreme Court determined that CCC had granted ISI a license within the meaning of the Franchise Practices Act, by allowing ISI to use CCC's name, by requiring ISI to use its "best efforts to promote CCC's name, trademark and logo," and by establishing ISI as the exclusive distributor of CCC products in the Marketing Territory. *Id.* at 351-55. The court reached this result despite the fact that ISI conducted business under its own name and did not pay a franchise fee to CCC. *Id.*

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[19] Two of the seven Justices dissented from the *Instructional Systems* decision on the grounds that the relationship between CCC and ISI was not a franchise within the meaning of the Franchise Practices Act. 130 N.J. at 380 (Clifford, J., and D'Annunzio, J.A.D. (temporarily assigned), dissenting).

Third, the New Jersey Supreme Court held that sufficient facts existed to determine that the CCC/ISI relationship showed a "community of interest," as the term is used by the Franchise Practices Act. *Id.* at 366. The court explained that the "community-of-interest requirement addressees the inequality of bargaining power between the parties and is critical in distinguishing franchises from other types of businesses." *Id.* at 356. The court explained:

> The Act's concern is that once a business has made substantial franchise-specific investments it loses all or virtually all of its original bargaining power regarding continuation of the franchise. Specifically, the franchise cannot do anything that risks termination, because that would result in a loss of much or all of the value of its franchise-related investments.

Id. at 357. The court then reviewed the facts and determined, *inter alia*, that (1) ISI had made "franchise-specific investments"—such as purchasing copyrighted computer software—and (2) ISI had developed goodwill and contacts, none of which could be used if the relationship with CCC ended. *Id.* at 362-66. Accordingly, the New Jersey Supreme Court concluded that a "community of interest" existed between ISI and CCC. *Id.* at 366.

Having found that the relationship between CCC and ISI constituted a franchise, the New Jersey Supreme Court then determined that the Franchise Practices Act had, at best, only incidental extraterritorial effect. *Id.* at 370-71. The court began, however, by recognizing two facts: (1) there was nothing to indicate that CCC intended or agreed that the Franchise Practices Act would apply to CCC's activities in states other than New Jersey and (2) New Jersey has no power to regulate commerce that occurs entirely beyond its borders. *Id.* at 367 (citing *Healy*, 491 U.S. 275; *Edgar* v. *MITE Corp.*, 457 U.S. 624 (1982)).

The New Jersey Supreme Court, nevertheless, distinguished *Healy* and *Edgar*. The court stated:

> [I]n contrast to *Edgar*, the [Franchise Practices Act] is applicable only to specific transactions affecting New Jersey, *i.e.*, franchises that have a "place of business" in New Jersey.
>
> Were it otherwise, nearly every aspect of substantive state law would be disabled from affecting the conduct of multi-state corporations. When New Jersey imposes a legal duty on the volitional behavior of a contracting party, that ruling will often have effects beyond state boundaries.

130 N.J. at 368–69.

The New Jersey Supreme Court also briefly analyzed the question of extraterritorial reach in terms of the due-process limitations on choice of law. *Id.* at 369. In this sense, the court stated that due process requires "contacts" with the forum, "interests" of the state arising out of those contacts and "fairness" to the defendant.[17] *Id.* (citing *Allstate Ins. Co.* v. *Hague*, 449 U.S. 302, *reh'g denied*, 450 U.S. 971 (1981)). The court then found that the Franchise Practices Act satisfied this test. The court stated:

> At its core, the New Jersey Franchise Practices Act is meant to deal with the unconscionable business practices affecting New Jersey franchises. Under the *Hague* formulation we surely find "contacts" with the forum, "interests" arising out of those contacts, and "fairness to the defendant" in the statute.

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[17] The court noted that this choice-of-law test "echoed" the Commerce Clause test established in *Pike* v. *Bruce Church, Inc.*, 397 U.S. 137 (1970), "in terms of the legitimacy of local interest and the reasonableness of regulation." *Instructional Systems*, 130 N.J. at 369.

> Fairness to the defendant is implicit in the statute's requirements. By definition, the Act, and particularly its community-of-interest requirement, is intended to protect business parties who made a franchise-specific capital investment of either goods or services in New Jersey.... Thus the statute's own terms, including the community-of-interest and good-cause requirements, will allow application of the Act only in situations in which there are "contacts" with the forum, "interests" arising out of those contacts, and "fairness to the defendant" in the sense that a defendant who acts fairly with a franchise need fear no oppressive regulation. *Therefore, the Act's own terms curtail impermissible extraterritorial effect and insure its constitutionality under Commerce Clause or due process analysis despite some incidental extraterritorial effects.*

Id. at 370–71 (emphasis added) (citations omitted).

Discussion

A. Summary Judgment Standard of Review

To prevail on a motion for summary judgment, the moving party must establish "there is no genuine issue as to any material fact and that [it] is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c). The present task is to determine whether disputed issues of fact exist, but a district court may not resolve factual disputes in a motion for summary judgment. *Anderson* v. *Liberty Lobby, Inc.*, 477 U.S. 242, 249–50 (1986); *see also Desvi, Inc.* v. *Continental Ins. Co.*, 968 F.2d 307, 308 (3d Cir. 1992) ("threshold inquiry is whether there are 'genuine factual issues that properly can be resolved only by a finder of fact because they may reasonably be resolved in favor of either party'") (citations omitted); *Gray* v. *York Newspapers, Inc.*, 957 F.2d 1070, 1078 (3d

Cir. 1992) ("We apply the test ... (1) Is there no genuine issue of material fact and (2) is one party entitled to judgment as a matter of law?") (quotations omitted); *Hackman* v. *Valley Fair*, 932 F.2d 239, 241 (3d Cir. 1991) ("summary judgment is inappropriate when a conflict of a material fact is present in the record"); *Nathanson* v. *Medical College of Pennsylvania*, 926 F.2d 1368, 1380 (3d Cir. 1991) (summary judgment may not be granted "if there is a disagreement over what inferences can be reasonably drawn from the facts even if the facts are undisputed").

All evidence submitted must be viewed in a light most favorable to the party opposing the motion. *Matsushita Elec. Indus. Co.* v. *Zenith Radio Corp.*, 475 U.S. 574, 587 (1986); *Williams* v. *New Castle County*, 970 F.2d 1260, 1264 (3d Cir. 1992); *Boyle* v. *Governor's Veterans Outreach & Assistance Center*, 925 F.2d 71, 75 (3d Cir. 1991); *Weldon* v. *Kraft, Inc.*, 896 F.2d 793, 797 (3d Cir. 1990); *Todaro* v. *Bowman*, 872 F.2d 43, 46 (3d Cir. 1989). "Any 'unexplained gaps' in materials submitted by the moving party, if pertinent to material issues of fact, justify denial of a motion for summary judgment." *Ingersoll-Rand Fin. Corp.* v. *Anderson*, 921 F.2d 497, 502 (3d Cir. 1990) (quoting *O'Donnell* v. *United States*, 891 F.2d 1079, 1082 (3d Cir. 1989)).

Although the summary judgment hurdle is a difficult one to overcome, it is by no means insurmountable. As the Supreme Court has stated, once the party seeking summary judgment has pointed out to the court the absence of a genuine issue of material fact,

> its opponent must do more than simply show that there is some metaphysical doubt as to the material facts. In the language of the Rule, the nonmoving party must come forward with "*specific facts* showing that there is a *genuine issue for trial*." Where the record taken as a whole could not lead a rational trier of fact to find for the non-moving party, there is no "genuine issue for trial."

Matsushita, 475 US. at 586–87 (emphasis in original, citations and footnotes omitted). In other words, the inquiry involves determining "'whether the evidence presents a sufficient disagreement to require submission to a jury or whether it is so one-sided that one party must prevail as a matter of law.'" *Brown* v. *Grabowski*, 922 F.2d 1097, 1111 (3d Cir. 1990) (quoting *Anderson*, 477 U.S. at 251–52), *cert. denied sub nom.*, *Roselle* v. *Brown*, 111 S.Ct. 2827 (1991); *see also Gray*, 957 F.2d at 1078 ("there is no issue for trial unless there is sufficient evidence favoring the nonmoving party for a jury to return a verdict for that party").

The Supreme Court elaborated on the summary judgment standard in *Anderson*: "If the evidence [submitted by a party opposing summary judgment] is merely colorable, or is not significantly probative, summary judgment may be granted." 477 U.S. at 249–50 (citations omitted). The Supreme Court went on to note in *Celotex Corp.* v. *Catrett*, 477 U.S. 317 (1986): "One of the principal purposes of the summary judgment rule is to isolate and dispose of factually unsupported claims or defenses, and we think it should be interpreted in a way that allows it to accomplish this purpose." *Id.* at 323–24 (footnote omitted); *see also Carlson* v. *Arnot-Ogden Memorial Hosp.*, 918 F.2d 411, 413 (3d Cir. 1990) ("nonmoving party must adduce more than a mere scintilla of evidence in its favor"); *Maguire* v. *Hughes Aircraft Corp.*, 912 F.2d 67, 72 (3d Cir. 1990) (non-moving party may not rest upon mere allegations); *Schoch* v. *First Fidelity Bancorporation*, 912 F.2d 654, 657 (3d Cir. 1990) (neither unsupported allegations in pleadings and memoranda of law nor conclusory allegations in affidavits will establish genuine issue of material fact); *Hozier* v. *Midwest Fasteners, Inc.*, 908 F.2d 1155, 1165 (3d Cir. 1990) (cannot create issue of fact merely by questioning credibility of movant's witnesses; circumstantial evidence may raise issue of fact); *Aronow Roofing Co.* v. *Gilbane Building Co.*, 902 F.2d 1127, 1128 (3d Cir. 1990) ("summary judgment will be granted where the non-moving party fails to 'establish the existence' of an element essential to the case").

B. Commerce Clause

1. Standard of Review

The Commerce Clause provides that "Congress shall have Power.... To regulate Commerce ... among the several States." U.S. Const., Art. I, § 8, cl. 3. The United States Supreme Court has long recognized that "this affirmative grant of authority to Congress also encompasses an implicit or 'dormant' limitation on the authority of the States to enact legislation affecting interstate commerce." *Healy*, 491 U.S. at 326 n.1 (citing *Hughes* v. *Oklahoma*, 441 U.S. 322, 326 & n.2 (1979); *H.P. Hood & Sons, Inc.* v. *Du Mond*, 336 U.S. 525, 534-35 (1949)); *see also Great Atlantic & Pacific Tea Co.* v. *Cottrell*, 424 U.S. 366, 370–71 (1976); *Cooley* v. *Board of Wardens*, 53 U.S. (12 How.) 299 (1852).

In determining whether a state statute improperly affects interstate commerce, the Supreme Court has stated:

> The principles guiding this assessment ... reflect the Constitution's special concern both with the maintenance of a national economic union *unfettered* by state-imposed limitations on interstate commerce and with the *autonomy of the individual States* within their respective spheres.

Healy, 491 U.S. at 336 (emphasis added).

The Supreme Court has indicated that its Commerce Clause jurisprudence concerning the extraterritorial effects of state economic regulation stand "at a minimum" for three propositions. *Id.*

> First, the Commerce Clause precludes the application of a state statute to commerce that takes place *wholly outside* of the State's borders, whether or not the commerce has effects within the State.

Id. (emphasis added); *see also Edgar* v. *MITE Corp.*, 457 U.S. 624, 642–43 (1982) (plurality opinion);

> Second, a statute that controls commerce occurring *wholly outside* the boundaries of a State exceeds the inherent limits of the enacting State's authority and is invalid regardless of whether the statute's extraterritorial reach was intended by the legislature. The critical inquiry is whether the *practical effect* of the regulation is to control conduct beyond the boundaries of the State.

Healy, 491 U.S. at 336 (emphasis added); *see also Brown-Forman Distillers Coop.* v. *New York State Liquor Authority*, 476 U.S. 573, 579 (1986); and

> Third, the practical effect of the statute must be evaluated not only by considering the consequences of the statute itself, but also by considering how the challenged statute may interact with the legitimate regulatory regimes of other States and what effect would arise if not one, but many or every, State adopted similar legislation.

Healy, 491 U.S. at 336.

The Supreme Court has explained that this last principle stands for two propositions: (1) "Generally speaking, the Commerce Clause protects against inconsistent legislation arising from the projection of one state regulatory scheme into the jurisdiction of another State," and (2) "specifically, the Commerce Clause dictates that no State may force an out-of-state merchant to seek regulatory approval in one State before undertaking a transaction in another." *Id.; see also Edgar*, 457 U.S. at 642; *Brown-Forman*, 476 U.S. at 582 ("[f]orcing a merchant to seek regulatory approval in one State before undertaking a transaction in another directly regulates interstate commerce").

In applying these principles, the Supreme Court has adopted a two-tiered approach to analyzing economic regulation under the Commerce Clause. *Healy*, 491 U.S. at 337 n.14; *Brown-Forman*, 476 U.S. at 578–79. When a statute "*directly regulates* or discriminates against interstate commerce, or when its effect is to favor in-state economic interests over out-of-state interests," the Court has "generally struck down the statute *without further inquiry*." *Healy*, 491 U.S. at 337 n.14 (emphasis added); *see also Brown-Forman*, 476 U.S. at 579 (citing *Edgar*, 457 U.S. at 640-43; *Philadelphia* v. *New Jersey*, 437 U.S. 617 (1978); *Shafer* v. *Farmers Grain Co.*, 268 U.S. 189 (1925)).

In contrast, when a statute "has only *indirect effects* on interstate commerce and regulates evenhandedly," the Court has "examined whether the State's interest is legitimate and whether the burden on interstate commerce clearly exceeds the local benefits."[18] *Healy*, 491 U.S. at 337 n.14 (emphasis added); *see also Brown-Forman*, 476 U.S. at 579; *Pike*, 397 U.S. at 142.

Because the Franchise Practices Act has the effect of *directly regulating* interstate commerce—specifically, transactions between non-New Jersey entities which take place wholly outside of New Jersey—this specific line of Supreme Court jurisprudence is discussed below.

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[18] Despite establishing the distinction in analysis between statutes having direct and indirect extraterritorial effect, the Supreme Court has indicated that "there is no clear line separating the category of state regulation that is virtually *per se* invalid under the Commerce Clause, and the category subject to *Pike* v. *Bruce Church* balancing approach." *Brown-Forman*, 476 U.S. at 579. In either situation, "the critical consideration is the overall effect on both local and interstate activity." *Id.* (citing *Raymond Motor Transp., Inc.* v. *Rice*, 434 U.S. 429, 440-41 (1978)).

2. Direct Regulation of Interstate Commerce

In a long line of cases, the Supreme Court has invalidated state statutes because those statutes have the effect of regulating transactions which take place wholly beyond the enacting state's borders. *Healy* is the most recent case in this line. In *Healy*, the State of Connecticut passed a law which required out-of-state shippers of beer to affirm that their posted prices for beer sold to Connecticut wholesalers were, at moment of posting, no higher than the prices at which those products were sold in states bordering Connecticut. 491 U.S. at 326. Moreover, in calculating the "lowest price" offered in border states, the Connecticut statute deducted from the reported price the value of any rebates, discounts, special promotions or other inducements that out-of-state shippers offered in one or more border states. *Id.* at 327.

The *Healy* Court invalidated the Connecticut statute. It determined that the statute had the extraterritorial effect "of preventing brewers from undertaking competitive pricing in [the border states] based on prevailing marketing conditions." *Id.* at 338. Two considerations affected this result. First, the Connecticut requirement that the posted price in Connecticut be no higher than in any bordering state had "the practical effect" of controlling prices in those bordering states because, months in advance, it locked brewers into those out-of-state prices. *Id.* at 338-39. Second, because volume discounts were permitted in Connecticut's border states, but not in Connecticut, and because the lowest of the volume-discounted prices would have to be offered as the regular price for in entire month in Connecticut, "the effect of Connecticut's affirmation scheme [was] to deter volume discounts in each [of Connecticut's] border states." *Id.* at 339.

On the basis of these extraterritorial effects, the *Healy* Court summarized the operative principle of law:

> The Connecticut statute ... requires out-of-state shippers to forgo the implementation of competitive

> pricing schemes in out-of-state markets because those pricing decisions are imported by statute into the Connecticut market regardless of local competitive conditions. As we specifically reaffirmed in *Brown-Forman*, States may not deprive businesses and consumers of "whatever competitive advantages they may possess" based on the conditions of the local market. The Connecticut statute does precisely this.

Id. at 339 (quoting *Brown-Forman*, 476 U.S. at 580). *Brown-Forman* presented almost the same situation.

In *Brown-Forman*, a New York statute required every liquor distiller or producer that sold liquor within New York to sell at a price that was no higher than the lowest price charged to wholesalers anywhere else in the United States. 476 U.S. at 575. Despite the facts that (1) the New York law regulated all distillers—both in and outside of New York—evenhandedly and (2) New York's asserted interest in assuring the lowest possible prices for its residents was legitimate, the Supreme Court struck down the statute as violative of the Commerce Clause. *Id.* at 579-84.

As in *Healy*, the *Brown-Forman* Court reasoned that the "practical effect" of the New York law was to set prices in other states and to require distillers to forgo competitive advantages in other states: "Once a distiller ha[d] posted prices in New York, it was not free to change its prices elsewhere in the United States during the relevant month." *Id.* at 582. The Court explained:

> While a State may seek lower prices for its consumers, it may not insist that producers or consumers in other States surrender whatever competitive advantages they may possess....
>
> The mere fact that the effects of New York's ABC Law are triggered only by sales of liquor within

> the State of New York ... does not validate the law if it regulates the out-of-state transactions of distillers who sell in-state.
>
> While New York may regulate the sale of liquor within its borders, and may seek low prices for its residents, it may not "project its legislation into [other states] by regulating the price to be paid" for liquor in those states.

Id. at 581-83 (quoting *Baldwin* v. *G.A.F. Seelig, Inc.*, 294 U.S. 511, 528 (1935)).

The *Brown-Forman* Court also rejected the argument that a distiller could avoid violating the New York Statute and its binding effects by seeking approval of the New York Liquor Authority to lower its prices in other states. *Id.* at 583. The Court explained that, even if such approval could be obtained, by no means a sure proposition, such an approach did not pass constitutional muster because "[f]orcing a merchant to seek regulatory approval in one State before undertaking a transaction in another directly regulates interstate commerce." *Id.* at 582.

Finally, in *Edgar*, the Supreme Court addressed the constitutionality of an Illinois statute whim required that any tender offer for the shares of an Illinois "target company" had to be registered with the Illinois Secretary of State. 457 U.S. at 626. A target company was defined by the Illinois statute as, *inter alia*, a corporation or other issuer of securities which met two of the following three conditions: the corporation (1) maintained its principal executive office in Illinois, (2) was organized under the laws of Illinois or (3) had at least 10 percent of its stated capital and paid-in surplus represented within the state. *Id.* at 627. The Illinois Secretary of State was permitted to deny registration of the takeover offer if, after a hearing, he or she determined the offer failed to provide full and fair disclosure to offerees of all material information.

As in *Healy* and *Brown-Forman*, the *Edgar* Court struck down the Illinois statute on the ground that the statute directly regulated interstate commerce and, specifically, transactions occurring entirely outside of Illinois. *Id.* at 640–43. The Court explained that, given the expansive definition of a "target corporation"—which required the corporation, rather than the corporation's shareholders, to be physically present in Illinois—the Illinois law "could be applied to regulate a tender offer which would not affect a single Illinois shareholder." *Id.* at 642. In other words, the Illinois statute gave the Illinois Secretary of State "nationwide reach ... to determine whether a tender offer may proceed anywhere." *Id.* at 643.

The *Edgar* Court concluded:

> It is therefore apparent that the Illinois statute is a direct restraint on interstate commerce and that it has a sweeping extraterritorial effect....
>
> The Commerce Clause ... precludes the application of a state statute to commerce that takes place wholly outside of the State's borders, whether or not the commerce has effects within the State....
>
> Because the Illinois Act purports to regulate directly and to interdict interstate commerce, including commerce wholly outside the State, it must be held invalid....[12]

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[12] The *Edgar* Court also analyzed the Illinois statute under the *Pike* balancing analysis and concluded that the local interests served did not outweigh the substantial burdens imposed upon commerce by the statute. The Court explained:

> The effects of allowing the Illinois Secretary of State to block a nationwide tender offer are substantial. Shareholders are deprived of the opportunity to sell their shares at a premium. The reallocation of economic resources to highest valued use,

(continued...)

Id. at 642–43 (citing *Shafer*, 433 U.S. at 197; *Southern Pac. Co.* v. *Arizona*, 325 U.S. 761, 775 (1945)).

3. New Jersey Franchise Practices Act as the Direct Regulation of Interstate Commerce

When examined in light of the Supreme Court's Commerce Clause jurisprudence, specifically, the decisions in *Healy*, *Brown-Forman* and *Edgar*, the Franchise Practices Act violates the Commerce Clause by directly regulating transactions which occur entirely outside of the state of New Jersey.

In the case *sub judice*, the 1984 Agreement expired in July 1989. Displeased with ISI's performance in all but three of the states in Marketing Territory, and facing a level of competition not in existence during earlier phases of its relationship with ISI, CCC made a business decision to change its methods of product distribution and sales. Accordingly, CCC chose not to renew its agreement with ISI on it previous terms. It desired instead to market directly its Integrated Learning Systems and other products in the Eight States, without employing ISI as a re-seller.

ISI invoked Section 56:10–15 of the Franchise Practices Act to prevent CCC from terminating its *exclusive* distributorship of CCC's products in the Eight States. ISI seeks an injunction to prohibit CCC, a non-New Jersey corporation, from selling its Integrated Learning Systems and other products, either directly or through another franchisee, to consumers in the area of the Eight States. Accordingly, if the Franchise Practices Act were applied in

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[12](...continued)

> a process which can improve efficiency and competition, is hindered. The incentive the tender offer mechanism provides incumbent management to perform well so that stock prices remain high is reduced.

457 U.S. at 643.

the manner suggested by ISI, and if the injunction were granted, the Act would have a *direct* effect on interstate commerce because it would prohibit transactions between non-New Jersey residents occurring entirely outside of New Jersey. Specifically, extraterritorial application of the Franchise Practices Act would (1) regulate distribution of CCC's products within other states, (2) prevent CCC from changing its method of distribution in these states and (3) prohibit interstate transactions between CCC and school districts in these states.[20]

The extraterritorial application of the Franchise Practices Act is a *per se* violation of the Commerce Clause. The Supreme Court has clearly established that the Commerce Clause "precludes the application of a state statute to commerce that takes place *wholly outside* of the State's borders, whether or not the commerce has effects within the State." *Healy*, 491 U.S. at 336; (emphasis added); *see also Edgar*, 457 U.S. at 642–43.

Similarly, while there is no question that New Jersey has the right to protect New Jersey franchisees, New Jersey has no right to regulate non-New Jersey transactions or to project its law

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[20] To the extent the New Jersey Supreme Court characterized the extraterritorial effects of the Franchise Practices Act as "incidental," its analysis is not adopted. The *Instructional Systems* court failed to analyze these effects in detail. Instead, because the Franchise Practices Act regulated New Jersey franchisees, the New Jersey Supreme Court simply stated that the Franchise Practices Act regulates "in-state conduct that has out-of-state effects." 130 N.J. at 368. Nevertheless, this situation is no different than in *Healy* or *Brown-Forman*. Like the New Jersey Franchise Practices Act, the statutes in *Healy* and *Brown-Forman* concerned only in-state transactions—*i.e.*, sales of alcohol. Nevertheless, because the effect of these statutes was to regulate commercial transactions entirely outside of the enacting states, the statutes were found to have extraterritorial *effects* violative of the Commerce Clause. Moreover, it is again noted that this precise issue—namely, the constitutionality of extraterritorial application of the Franchise Practices Act—was reserved by CCC for consideration by this court. *See supra* at p. 15.

into other states.[2]/ Again, the Supreme Court has established that "a statute that controls commerce occurring *wholly outside* the boundaries of a State *exceeds the inherent limits of the enacting State's authority and is invalid* regardless of whether the statute's extraterritorial reach was intended by the legislature." *Healy*, 491 U.S. at 336 (emphasis added); *see also Brown-Forman*, 476 U.S. at 579. The critical inquiry, whether the *practical effect* of the regulation is to control conduct beyond the boundaries of the State, is clearly met in this case. *See Healy*, 491 U.S. at 336; *see also Brown-Forman*, 476 U.S. at 579.

Extraterritorial application of the Franchise Practices Act also has the direct effect of imposing New Jersey state law on the creation of franchise relationships and to the selling of products in other states. The Commerce Clause, however, "protects against inconsistent legislation arising from the protection of one state regulatory scheme into the jurisdiction of another State," and insures "the autonomy of the individual States within their respective spheres," *Healy*, 491 U.S. at 336; *see also Edgar*, 457 U.S. at 642.

In this case, prohibiting CCC from directly or indirectly marketing its products in the Eight States, other than through ISI, would mean that, as far as the 1984 Agreement is concerned, New Jersey Law would replace the law of Connecticut, Delaware, the District of Columbia, Maine, Maryland, New Hampshire, Rhode Island and Vermont. This result is problematic. As well, it appears only three of the Eight States have adopted franchise termination legislation similar to New Jersey. *See* Conn. Gen. Stat. Ann. § 42-133f(a); Del. Code Ann. tit. § 2252(a); D.C. Code Ann. § 29-1203; *see also* Reynolds, *Good Cause For Franchise*

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[2]/ CCC does "not question New Jersey's power to protect in-state franchises insofar as their distribution activities within New Jersey are concerned." Moving Brief at 20 (emphasis omitted). Thus, CCC "does not dispute that New Jersey may apply the [Franchise Practices Act] to distribution activities within its borders." Secondary Reply Brief at 2.

Termination: An Irreconcilable Difference Between Franchise Fault and Franchisor Market Withdrawal, 1992 B.Y.U.L.Rev. 785 n.7; 2 W.M. Garner, *Franchise and Distribution Law and Practice*, § 10:01 (1990).

Whether the absence of franchise termination legislation in several states in the Marketing Territory reflects a conscious choice on the part of those states to not protect franchisees is irrelevant.[22/] The important point is that applying the New Jersey Franchise Practices Act in states without such regulation—on transactions between or among non-New Jersey residents occurring wholly outside of New Jersey—imposes restrictions on franchise regulation, if not formation, and on the selling of goods not otherwise present in those states.[23/] Such extraterritorial

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[22/] As stated by CCC, franchise termination laws raise significant issues of economic policy and have engendered "intense debate and considerable controversy." *See* Moving Brief at 21 (quoting ABA Antitrust Sec., Monograph No. 17, *Franchise Protection: Laws Against Termination and the Establishment of Additional Franchises*, 2, 19-70 (1990)). Proponents have argued such laws are necessary to protect franchisees from unscrupulous treatment by franchisors. *See, e.g., General Motors Corp.* v. *Gallo GMC Truck Sales, Inc.*, 711 F. Supp. 810, 814 (D.N.J. 1989); *Shell Oil Co.* v. *Marinello*, 63 N.J. 402, 409 (1973), *cert. denied*, 415 U.S. 920 (1974).

In contrast, opponents have argued such legislation injures consumers, interferes with freedom of contract and is anti-competitive because it prevents manufacturers from choosing the most efficient means to distribute their products. *See, e.g., Original Great Am. Chocolate Chip Cookie Co.* v. *River Valley Cookies, Ltd.*, 970 F.2d 273, 282 (7th Cir. 1992); Reynolds, *Good Cause For Franchise Termination*, 1992 B.Y.U.L.Rev. 785; Brickley, Dark & Weisbach, *The Economic Effects of Franchise Termination Laws*, 34 J.L. & Econ. 101, 126 (1991).

[23/] Nationwide, it appears only seventeen states, the District of Columbia, Puerto Rico and the Virgin Islands have adopted general franchise termination statutes. *See* Ark. Code Ann. § 4-72-204; Cal. Bus. & Prof. Code § 20020; Conn. Gen. Stat. Ann. § 42-133f(a); Del. Code Ann. tit. 6, § 2552; D.C. Code. Ann. § 29-1203; Haw. Rev. Stat. § 482E-6; Ill. Rev. Stat. ch. 815, ¶ 705, § 19 & ¶ 710, § 9; Ind. Code Ann. § 23-2-2.7-1; Mich. Comp. Laws Ann. § 445.1527; Minn.

(continued...)

imposition of New Jersey law infringes on state autonomy and creates the very inconsistency in legislation which the Commerce Clause was designed to protect. *See Healy*, 491 U.S. at 336. New Jersey simply may not project its legislation into other states, as contemplated in this case. *Brown-Forman*, 476 U.S. at 582–83.

Finally, the Franchise Practices Act *per se* violates the Commerce Clause because no state may force an out-of-state merchant to seek approval in that state before undertaking a transaction in another state. *Healy*, 491 U.S. at 336; *Edgar*, 457

22/(...continued)
Neb. Rev. Stat. § 87–404; N.J.S.A. § 56:10–15; P.R. Laws Ann. tit 14, § 278a; Tenn. Code Ann. §§ 47–25–1503 to 1504; Va. Code Ann. § 13.1–564; V.I. Code Ann. tit. 12a, § 132; Wash. Rev. Code Ann. § 19.100.180; Wis. Stat. Ann. § 135.03.

Seven of these states distinguish between termination and renewal—allowing non-renewal of franchise agreements with no "good cause" requirement—or require merely that notice be given prior to non-renewal or termination. *See* Cal. Bus. & Prof. Code § 20020; Mich. Comp. Laws Ann. § 445.1527; Minn. Stat. Ann. § 80C.14(3)–(4); Miss. Code Ann. § 75–24–53; Mo. Ann. Stat. § 407.405; Va. Code Ann. § 13.1-564; Wash. Rev. Code Ann. § 19.100.180(2)(i)–(j); *see also* Ind. Code Ann. § 23–2–2.7–1 (requiring good cause for non-renewal but also providing that statute "shall not prohibit a franchise agreement from providing that the agreement is not renewable upon expiration"); Neb. Rev. Stat. § 87–404 (same).

Congress has declined to enact a Federal franchise termination statute, after hearing testimony opposing such a statute from both the Department of Justice and the American Bar Association. *See* Hearings on H.R. 5016 Before Subcomm. on Consumer Protection and Finance of the House Comm. on Interstate and Foreign Commerce, 95th Cong., 1st Sess., 50 (1977) (testimony of Joe Sims, Deputy Assistant Attorney General, Department of Justice); Hearings on S. 1256 Before Senate Judiciary Comm., 97th Cong., 2d Sess., 19–21 (1982) (testimony of William Baxter, Assistant Attorney General, Department of Justice); *see also* "ABA Adopts Resolution Opposing Franchise Bill," 852 Antitrust & Trade Reg. Rep. (BNA) A-15 (23 Feb. 1978).

U.S. at 642. This is precisely the effect of the "good cause" requirement of the Franchise Practices Act. Absent a showing of "good cause" for non-renewal, the Franchise Practices Act would prohibit CCC from marketing its products—directly or indirectly through a new distributor—in the Eight States, despite the fact that the 1984 Agreement has expired by its own terms.

In effect, CCC could not regain the right to sell its products in the Eight States—covering an area of more than 65,000 square miles outside of New Jersey's borders—until it established, to the satisfaction of a New Jersey court, that it had met New Jersey's statutory requirement of termination or non-renewal for "good cause." Until that time, the 1984 Agreement would continue in virtual perpetuity, despite its contractually agreed-upon expiration date.[24] *See Instructional Systems*, 130 N.J. at 372 (recognizing

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[24] This prohibition is particularly harsh in a case, such as this, in which the franchisor has granted an *exclusive* multi-state distribution relationship with a New Jersey franchisee. In effect, in ten states outside of New Jersey, the Franchise Practices Act would require CCC to market its products through ISI or not at all.

In this regard, the Franchise Practices Act violates the Commerce Clause by requiring CCC to forgo potential economic advantages in non-New Jersey markets. *Healy*, 491 U.S. at 339; *Brown-Forman*, 476 U.S. at 580. The Act prohibits CCC from changing its distribution methods no matter how much the industry has changed over the course of the 1984 Agreement and irrespective of whether CCC or a different distributor could do a better job than ISI. *See Instructional Systems*, 130 N.J. at 374 (dissent) (citing *Westfield Centre*, 86 N.J. 453; *New Jersey Am.*, 875 F.2d 58). It is significantly burdensome for the Franchise Practices Act to prohibit CCC from pursuing marketing opportunities in states otherwise neglected by ISI—such as Maine, New Hampshire and Vermont—given the highly competitive nature of the Integrated Learning Systems business. *See supra* at pp. 7-9, nn.4, 10. As the court recognized in *Central GMC, Inc.* v. *General Motors Corp.*, 946 F.2d 327 (4th Cir. 1991), *cert. denied*, 112 S.Ct. 1265 (1992):

> The restrictions implicit in the [C]ommerce [C]lause are designed to deflect such rigidity in our national economic system and to prohibit states from hindering the "reallocation

(continued...)

that only judicial inquiry on a case-by-case basis can decide whether Franchise Practices Act "bestow[s] a franchise for as long as the franchisee chooses to retain it").

As the Supreme Court indicated in *Brown-Forman*: "Forcing a merchant to seek regulatory approval in one State before undertaking a transaction in another *directly regulates* interstate commerce." 476 U.S. at 582 (emphasis added). Furthermore, in this case, the burden on interstate commerce is particularly onerous. Because the Franchise Practices Act requires judicial approval, rather than regulatory approval, an out-of-state franchisor will likely be required to engage in protracted and expensive litigation before it is free from the constraints of the Franchise Practices Act. *See Instructional Systems*, 130 N.J. at 374 ("many attempts by a franchisor to terminate a franchise for good cause will result in litigation") (dissent).

This case illustrates the fact of delay, as well as impact on interstate commerce, by the application of the Franchise Practices Act. The present dispute has been ongoing for four years. During this time, the case has been reviewed by the Chancery Division of the New Jersey Superior Court, the Appellate Division of the New Jersey Superior Court, the New Jersey Supreme Court and now is back before this court.[25] Nevertheless, after four years of litigation, the *only* issues that have been decided are those related to the preliminary issue of whether the CCC/ISI relationship constituted a franchise subject to the provisions of the Franchise Practices Act. Although this question has been answered by the New Jersey Supreme Court in the affirmative, CCC's right to

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[24](...continued)

> of economic resources to their highest valued use, a process which can improve efficiency and competition."

Id. at 334 (quoting *Edgar*, 457 U.S. at 643).

[25] As stated, this case was originally filed in New Jersey Superior Court and later removed to this court. *See supra* at n.14.

market its products in the Eight States outside of New Jersey has still not been resolved. The New Jersey Supreme Court did not decide, *inter alia*, whether CCC had good cause to not renew the 1984 Agreement or whether ISI waived its right to renewal by signing the 1989 Agreement. *See Instructional Systems*, 130 N.J. at 373. After four years of litigation, extraterritorial application of the Franchise Practices Act still prohibits CCC from selling its products in the Eight States outside of New Jersey.

As argued by CCC, the bottom line in this case is that the Franchise Practices Act compels CCC to undergo protracted litigation to exercise a right that New Jersey cannot constitutionally regulate—namely, the right of a non-New Jersey corporation to market and sell its products in states outside out New Jersey. These transactions neither cross New Jersey's borders nor involve New Jersey parties.

It is a *per se* violation of the Commerce Clause for New Jersey to regulate directly these wholly extraterritorial transactions, to impose its statutory scheme on other states and to require out-of-state franchisors to seek New Jersey judicial approval before entering into out-of-state transactions. *Healy*, 491 U.S. at 336; *Brown-Forman*, 476 U.S. at 581–83; *Edgar*, 457 U.S. at 642–43.

4. Arguments That Franchise Practices Act Does Not Violate Commerce Clause

ISI and the New Jersey Attorney General make numerous arguments in support of the position that the Franchise Practices Act does not violate the Commerce Clause. These arguments, reviewed below, are without merit.

a. **Argument that Franchise Practices Act is Narrowly Drawn**

ISI initially argues that the Franchise Practices Act is narrowly drawn and regulates only New-Jersey based relationships between franchisors and franchisees. ISI Opp. Brief at 11–13. According to the ISI:

> The statute was carefully drafted to preclude its application to franchisor-franchisee relationships that exist entirely outside of the state. By its own terms, the (Franchise Practices Act) applies only to those franchise relationships in which New Jersey has a compelling interest. It applies only to a franchise "the performance of which contemplates or requires the franchisee to establish or maintain a place of business within the State of New Jersey."

Id. at 12 (quoting N.J.S.A. § 56:10–4).

This argument misses the point. As the Supreme Court has indicated, the "critical inquiry is whether the *practical effect* of the regulation is to control conduct beyond the boundaries of the State." *Healy*, 491 U.S. at 336; *see also Brown-Forman*, 476 U.S. at 579. Because the *effect* of the Franchise Practices Act is to directly regulate transactions which occur wholly outside of New Jersey between non-New Jersey parties, the Franchise Practices Act *per se* violates the Commerce Clause, regardless of whether (1) the Franchise Practices Act was intended to apply only to in-state franchise relationships, (2) New Jersey has a legitimate interest in seeking to protect New Jersey franchisees and (3) the out-of-state transactions have effects within New Jersey. *Healy*, 491 U.S. at 336; *see also Brown-Forman*, 476 U.S. at 579.

The very argument of ISI underscores the point of a *per se* Commerce Clause violation. ISI argues:

> The legislative and public policy interest upon which the [Franchise Practices Act] is founded—the equalization of bargaining power between franchisees and franchisors—requires that the entire relationship between the parties, *not just that portion of the relationship that results in sales within New Jersey*, be governed by the Act's terms. By definition, *if its application is restricted to New Jersey sales*, the [Franchise Practices Act] cannot protect a New Jersey "hub-type" franchisee's investment in its multistate business from a franchisor's unfair termination of portions of the multistate territory which the franchisor granted to the franchisee in the parties' contract.

ISI Opp. Brief at 12 (emphasis added). While this argument may indeed be true, the point is that New Jersey cannot impose its law on other states by applying the Franchise Practices Act to sales that take place outside of New Jersey.[25] *Brown-Forman*, 476 U.S. at 581-83; *Baldwin*, 294 U.S. at 528.

As a final point with regard to this argument by ISI, this case is indistinguishable from *Healy*, *Brown-Forman* and *Edgar*. In

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[25] This point is also missed by the Attorney General, who states:

> [I]t is not a matter of constitutional concern that the New Jersey Franchise Practices Act protects the franchisee not only with respect to that part of the franchise territory that geographically encompasses New Jersey, but with respect to the entirety of that territory, *including those parts outside of New Jersey*.

Attorney General Opp. Brief at 29. These positions are directly contrary to *Healy*, *Brown-Forman* and *Edgar*, which dictate that a state may not project its law into another state. *See supra* at pp. 24, 26-30. Thus, to the extent "hub-type" franchise relationships centered in New Jersey are to be protected, this protection is provided by the parties' contract; if the franchise is wrongfully terminated, contract and quasi-contract causes of action would apply.

all of these cases, the statutes found to violate the Commerce Clause purported only to apply to transactions occurring within the state and involving protection of state residents. For instance, in both *Healy* and *Brown-Forman*, the statutes on their face regulated only the prices of in-state sales of alcohol. *Healy*, 491 U.S. at 326; *Brown-Forman*, 476 U.S. at 583. Nevertheless, the Supreme Court struck down these statutes because their practical effect was to regulate prices out-of-state. *Healy*, 491 U.S. at 338-39; *Brown-Forman*, 476 U.S. at 581-83. In *Edgar*, despite the fact that the statute purported to apply only to tender offers for Illinois target corporations, the statute was found to violate the Commerce Clause because it regulated the sale of stock outside of Illinois. 457 U.S. at 626, 640-43. There simply is no difference in this case. The argument that the Franchise Practices Act is narrowly drawn to regulate only New Jersey based franchise relationships is unavailing, given that the practical effect of the Act is to regulate sales that take place outside of New Jersey.

b. **Argument that Franchise Practices Act Does Not Regulate Commerce Outside of New Jersey**

ISI argues that the Franchise Practices Act does not regulate commerce outside of New Jersey. According to ISI, *Healy*, *Brown-Forman* and *Edgar* stand for the proposition that "the rule of *per se* constitutional infirmity is limited to cases in which the enacting state lacks an interest in, or connection to, the commerce that it regulates." ISI Opp. Brief at 17. ISI then argues: "The [Franchise Practices Act]'s function is entirely different. By its own terms, it cannot apply to an out-of-state franchise, or to any other economic relationship occurring outside of this state." *Id.* at 17-18.

The distinction drawn by this argument does not exist. As discussed at length above, *see supra* at pp.31-39, the Franchise Practices Act has the effect of regulating out-of-state economic relationships and sales by requiring the 1984 Agreement to remain in effect after expiration on its own terms. Because the Franchise Practices Act restricts and prohibits the ability of CCC, an out-of-

state franchisor, from selling its products or entering into new franchise relationships in the Eight States outside of New Jersey without judicial approval, it does regulate extraterritorial economic relationships.[27] This is more than clear from the injunction requested by ISI, which seeks to prohibit CCC from marketing its products in the Eight States in any way other than through ISI in accordance with the long-expired 1984 Agreement.

Again, there is no distinction between this case and *Healy*, *Brown-Forman* or *Edgar*. In each of these cases, the enacting state's only interest—and only justification—in regulating out-of-state businesses was to regulate in-state conduct and to protect its citizens from the in-state activities of out-of-state businesses. For instance, in *Healy* and *Brown-Forman*, Connecticut and New York sought only to regulate the price of beer and alcohol sold *within* their states. Similarly, in *Edgar*, Illinois sought to regulate only tender offers for target companies *within* the state.

The statutes in *Healy*, *Brown-Forman* and *Edgar* "by their own terms" could not apply to out-of-state pricing arrangements or to non-state-related target corporations. Nevertheless, because out-of-state conduct was effected by the relevant legislation, the statutes in *Healy*, *Brown-Forman* and *Edgar* were found to violate the Commerce Clause. Accordingly, it is irrelevant that, as argued by ISI, the Franchise Practices Act "by its terms" regulates only New Jersey franchise arrangements when the practical effect of the statute is to regulate non-New Jersey sales and franchise relationships. The Franchise Practices Act attempts to protect in-state interests by asserting control over out-of-state commercial

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[27] Like the New Jersey Supreme Court, ISI characterizes the effect of the Franchise Practices Act on interstate commerce as "incidental." As discussed above, however, there is no basis for this argument. *See supra* n.20.

relationships.[2/] As ISI concedes in discussing *Healy*, such a situation violates the Commerce Clause. *See* ISI Opp. Brief at 18.

In support of the position that the Franchise Practices Act does not regulate commerce outside of New Jersey, both ISI and the Attorney General cite two cases—*Mon-Shore Management, Inc.* v. *Family Media, Inc.*, 584 F. Supp. 186 (S.D.N.Y. 1984) and *CSS-Wisconsin Office, etc.* v. *Houston Satellite Systems, Inc.*, 779 F. Supp. 979 (E.D.Wis. 1991). These cases, however, are distinguishable.

In *Mon-Shore Management*, the New York statute at issue required franchise sellers to register in New York and to provide full financial disclosure when an offer to sell originated, was extended or accepted in New York. 584 F. Supp. at 189. It was argued that this law, "insofar as it govern[ed] the offer and sale of franchises to out-of-state parties, constitute[d] a direct and excessive burden on interstate commerce." *Id.* at 190. The *Mon-Shore* court rejected this argument, finding that "[t]he New York statute cannot have any effect whatsoever on the nationwide marketing of franchises if the franchisor elects to conduct his activities outside of this State and with non-residents." *Id.* at 191.

The New York franchise act in *Mon-Shore* differs significantly from the New Jersey Franchise Practices Act. As discussed, by effectively extending a franchise agreement in

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[2/] Even the Attorney General recognizes the parochial nature of the Franchise Practices Act. The Attorney General states:

> [T]he statute is but one example of a broad and virtually endless array of regulatory provisions enacted *to protect state citizens and [the State's] economic and social well-being.*

Attorney General Opp. Brief at 18. This is precisely the kind of local protectionism when applied to out-of-state commercial transactions that has been found to violate the Commerce Clause.

perpetuity, the Franchise Practices Act has the effect of regulating transactions between non-New Jersey parties that occur entirely outside of New Jersey. *See supra* at pp. 31-39. In contrast, the New York franchise act in *Mon-Shore* was not implicated unless the transaction at issue—namely, the offering for sale of a franchise—occurred in or was consummated in New York. In other words, there was no danger in *Mon-Shore* of the New York law applying to a transaction wholly unrelated to the state, involving entirely non-New York parties.[28]

In *CSS-Wisconsin Office*, the court was faced with the question of whether, under choice-of-law principles, the Wisconsin Fair Dealership Law could apply to the dispute. 779 F. Supp. at 982. Rather than mounting a full-fledged Commerce Clause challenge, the defendant argued in passing that application of the Wisconsin law "to the present controversy may present difficulties under the [C]ommerce [C]lause." *Id.* at 986. Without engaging in any significant analysis, the court stated that "because the distributor relationship . . . involves commerce that actually takes place in Wisconsin, the court is not persuaded that applying the Wisconsin Fair Dealership law to the distributor relationship would offend the commerce clause." *Id.*

Put simply, *CSS-Wisconsin* is not a persuasive authority. At best, the court's analysis is brief and does not discuss what, if any, extraterritorial effects would have resulted from the application of the Wisconsin statute to states outside of Wisconsin. Moreover, the central question in *CSS-Wisconsin* involved which law was to be properly applied in the case, meaning that the court was concerned with such questions as Wisconsin's interest in applying its law and the extent of the parties' contacts with the state.[29] As discussed,

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[28] In addition, it is noted that *Mon-Shore* was decided prior to the Supreme Court's decisions in *Healy* and *Brown-Forman* and, therefore, lacked the benefit of these decisions.

[29] This analysis is similar to the analysis conducted by the New Jersey Supreme (continued...)

these considerations do not impact the analysis of *per se* Commerce Clause violations. Accordingly, to the extent *CSS-Wisconsin* may take a position contrary to this Opinion, its reasoning is rejected in light of the clear Supreme Court authority in *Healy*, *Brown-Forman* and *Edgar*.

c. **Argument That Franchise Practices Act Does Not Conflict With Other States' Law**

Although ISI concedes that numerous other states in the original Marketing Territory "do not regulate franchise relationships at all," *see* ISI Opp. Brief at 23 & n.14, ISI argues that the Franchise Practices Act does not conflict with the regulation of those other states. ISI states:

> [T]he franchisor is not required by the [Franchise Practices] Act to award a multistate territory to a New Jersey franchisee. Thus, the statute does not contradict or contravene the franchise regulation scheme of any of the states at issue.... ISI's entitlement to the [Franchise Practices] Act's protection over its agreed-upon multistate territory by New Jersey law will not preclude the enforcement of the franchising law of other affected States. Were it otherwise, choice of law governance of contractual relationships which have multistate manifestations would be meaningless.

Id. at 23-24.

This argument is without merit. As discussed, applying the New Jersey Franchise Practices Act in states without such regulation—on transactions between non-New Jersey entities

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[20](...continued)
Court. *See* 130 N.J. at 366–69. As discussed, *see supra* at n.20, this analysis is not adopted.

occurring entirely outside of New Jersey—imposes restrictions on franchise regulation, if not formation, and on the selling of goods not otherwise present in those states. In states where CCC would otherwise be able to sell its products unimpaired, such as Maine, Maryland Massachusetts, New Hampshire, Rhode Island and Vermont, which ISI concedes have no franchise termination statutes, *see* ISI Opp. Brief at 23 n.14, the Franchise Practices Act would preclude those sales. The imposition by New Jersey of the Franchise Practices Act restrictions interferes with the regulatory autonomy of these states, in violation of the Commerce Clause.

Contrary to ISI's suggestion, unconstitutional interference is present just as much in situations where states have chosen not to enact certain types of legislation, as where conflicting legislation has been enacted. For instance, in *Hyatt Corp.* v. *Hyatt Legal Servs.*, 610 F. Supp. 381 (N.D.Ill. 1985), the court was faced with an analogous situation in which a plaintiff was seeking a nationwide injunction based upon Illinois' trademark anti-dilution statute. Analyzing the issue in the context of the Supreme Court's Commerce Clause jurisprudence, the *Hyatt* court refused to issue a nationwide injunction and stated:

> The rights accorded plaintiff by Illinois are not of a nature commonly recognized elsewhere. Whether or not to extend protection in the absence of any likelihood of confusion is customarily a legislative policy decision. Though a number of states have anti-dilution statutes . . . a majority do not. *Imposing Illinois' anti-dilution law upon those states that have chosen not to pass such a law, in some cases possibly by explicit choice . . . is an anathema to our federal system.*

610 F. Supp. at 385 (citing *Blue Ribbon Feed Co.* v. *Farmers Union Central Ex., Inc.*, 731 F.2d 415, 422 (7th Cir. 1984)).

The same issues are present with regard to the Franchise Practices Act. Accordingly, because extraterritorial enforcement of the statute would impose rights and restrictions granted by New Jersey that do not exist in most of the states within the Marketing Territory, the Commerce Clause—as well as the notions of state autonomy and comity which support the Commerce Clause—dictate that the Franchise Practices Act not be given extraterritorial application. New Jersey cannot impose its regulation or policy choices on other states. *See Wright-Moore Corp.* v. *Ricoh Corp.*, 794 F. Supp. 844, 860-61 (N.D. Ind. 1991) (refusing to give Indiana Deceptive Franchise Practices Act extraterritorial application, recognizing that "[c]learly, other states' legislatures can give protection to franchises within the states' borders if they so wish" and that "giving Indiana's franchise statute extraterritorial effect raises Commerce Clause issues"), *aff'd*, 980 F.2d 432 (7th Cir. 1992).

d. Argument That Franchise Practices Act Regulates Even-Handedly and Does Not Discriminate Between New Jersey and Non-New Jersey Franchisees

The Attorney General, and to a limited degree ISI, argue that the Franchise Practices Act does not *per se* violate the Commerce Clause because it does not discriminate between New Jersey and non-New Jersey franchisors. *See* Attorney General Opp. Brief at 5, 9; *see also* ISI Opp. Brief at 35-36 (making same argument). The Attorney General states:

> The law of the Commerce Clause is that a *per se* standard is not to be applied unless a statute is discriminatory against out-of-state interests on its face or in its obvious purpose or effect against interstate commerce; the New Jersey Franchise Practices Act plainly does none of these.

Attorney General Opp. Brief at 5. The Attorney General also states:

> As long as the state statutory scheme does not compel out-of-state residents to bear the brunt of the scheme for no reason other than that they live and vote in other states, and as long as nothing in the statute or its history indicates a discriminatory purpose, the statute will readily survive under the *per se* standard.

Id. at 9.

Although it appears the Franchise Practices Act applies equally to in-state and out-of-state franchisors, this argument simply misstates the law which forms the basis finding that the Franchise Practices Act *per se* violates the Commerce Clause. As the Supreme Court has stated repeatedly, a statute is *per se* unconstitutional when in "*directly regulates or* discriminates against interstate commerce." *Healy*, 491 U.S. at 337 n.14 (emphasis added); *Brown-Forman*, 476 U.S. at 579. In other words, the *per se* rule is not confined to laws which discriminate against interstate commerce; it includes, as well, those laws that "directly regulate" transactions occurring entirely out-of-state. *See Beyer Farms, Inc.* v. *Brown*, 721 F. Supp. 644, 647 (D.N.J. 1989) (recognizing that direct regulation of interstate commerce and discrimination are separate violations of Commerce Clause).

That this argument lacks merit is evident from the analytical framework of the Supreme Court's decision in *Healy*. The *Healy* Court, in analyzing the Connecticut price-posting statute, first determined that the statute violated the Commerce Clause because it had "the undeniable effect of controlling commercial activity occurring wholly outside the boundary of the State." 491 U.S. at 337. Then, in an entirely separate section of the opinion, the *Healy* Court recognized: "The Connecticut statute, moreover, violates the Commerce Clause in a *second respect:* On its face, the statute

discriminates against brewers and shippers engaged in interstate commerce." *Id.* at 340 (emphasis added). Thus, in *Healy*, the Supreme Court found direct regulation and discrimination to be separate, equally-viable bases for striking down statutes under the Commerce Clause.

Courts have often recognized that a statute can violate the Commerce Clause without having a discriminatory effect. In *Brown-Forman*, for instance, the Supreme Court struck down the New York price-posting statute, even though it was conceded that the statute even-handedly regulated in-state and out-of-state distillers, on the ground that New York had "projected its legislation into other states, and directly regulated commerce therein." 476 U.S. at 579, 582-84; *see also Old Bridge Chemicals, Inc. v. New Jersey Dep't of Envt'l Prot.*, 965 F.2d 1287, 1293 (3d Cir.) (recognizing that "[t]he Supreme Court has invalidated state statutes where a state has 'projected' its legislation into other states and directly regulated commerce therein"), *cert. denied*, 113 S.Ct. 602 (1992).

Accordingly, because the Franchise Practices Act *directly* regulates interstate commerce—and particularly transactions between non-New Jersey residents occurring entirely outside of New Jersey—it is *per se* violative of the Commerce Clause despite the absence of any discriminatory purpose or effect.

e. Argument That Franchise Practices Act Does Not Violate Commerce Clause Because This Is an "Atypical" Situation

The Attorney General argues:

> In the vast run of situations there is *no* burden whatever [on interstate commerce), since

> undoubtedly most franchise arrangements concern business operations solely within New Jersey.

Attorney General Opp. Brief at 28.

This argument is without merit. As an initial matter, the Attorney General misconstrues CCC's position. As noted, *see supra* n.21, CCC does "not question New Jersey's power to protect in-state franchises insofar as their distribution activities within New Jersey are concerned," Moving Brief at 20 (emphasis omitted), nor does CCC "dispute that New Jersey may apply the [Franchise Practices Act] to distribution activities within its border. Secondary Reply Brief at 2. Instead, CCC only challenges the Franchise Practices Act "insofar as it has been construed to apply to CCC's distribution activities in other states." Secondary Reply Brief at 2.

More significantly, however, the Attorney General has cited no authority to support the proposition that a state may regulate commerce that occurs entirely outside its borders, so long as it only does so in "atypical" situations. The rule of law is simple and unequivocal: A state statute that has the practical effect of regulating conduct wholly outside of its borders "exceeds the inherent limits of the enacting state's authority" and *per se* violates the Commerce Clause. *Healy*, 491 U.S. at 336; *Brown-Forman*, 476 U.S. at 579; *Edgar*, 457 U.S. at 642-43.

That the majority of franchise arrangements may operate solely inside of New Jersey is irrelevant because the Franchise Practices Act will have the same extraterritorial effect in *every case* that concerns multi-state franchise arrangements and a non-New Jersey franchisor. Thus, even if multi-state arrangements can be characterized as atypical,[21/] the consistency with which the

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[21/] The Attorney General has provided no support—factual or otherwise—for the contention that multi-state franchises based in New Jersey are atypical. In fact, even ISI recognizes that New Jersey is "centrally located" and, given its "strategic (continued...)

Franchise Practices Act will, in such situations, have the effect of regulating transactions wholly outside of New Jersey between non-New Jersey parties brings the statute within the *per se* prohibition of the Commerce Clause. *See Motor Vehicle Mfrs. Ass'n v. Abrams*, 720 F. Supp. 284, 288 (S.D.N.Y. 1989) (recognizing that "innocuous" as a statutory requirement on out-of-state franchises may be, such requirements have the "effect of regulating commerce in other states in violation of the Commerce Clause") (citations omitted).

f. Argument That CCC Cannot Use the Commerce Clause to Rewrite Its Contract With ISI

Finally, it is argued that CCC is attempting to use the Commerce Clause as a means for re-writing its contract with ISI. For instance, the Attorney General states:

> [N]o one forced CCC to grant ISI a multi-state territory. The Franchise Practices Act had been in effect for more than a decade before the 1984 [A]greement, and CCC therefore must be presumed to have been aware of its requirements. It could have avoided its present difficulties simply by granting ISI a franchise territory covering New Jersey and nothing more, yet it did not do so. CCC cannot now use the Commerce Clause as the guise for having this [c]ourt rewrite its own contract.

Attorney General Opp. Brief at 30; *see also* ISI Opp. Brief at 30-31 (making same argument).

This argument, too, is without merit. Contrary to the above suggestion, this is not a case in which CCC is attempting to

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21/(...continued)
position," provides an effective base "to service an extensive territory." ISI Opp. Brief at 4.

terminate a contract prematurely. As expressly stated in the 1984 Agreement and agreed-upon by the parties, the 1984 Agreement expired on 31 July 1989. Upon expiration, CCC determined that it would not renew its re-seller arrangement with ISI on the same terms as before. In fact, as mentioned, the 1984 Agreement contains *no* provision requiring renewal beyond the expiration date of the contract, let alone renewal on identical terms.

It is disingenuous to argue that CCC is attempting to have the court re-write its contract with ISI when that very contract provided for application of California law and by its terms expired almost four years ago. To the extent the terms of the 1984 Agreement continue to apply to the CCC/ISI relationship, they do so only because the Franchise Practices Act requires the contract to continue in perpetuity until CCC can demonstrate that "good cause" exists for its failure to renew the 1984 Agreement in its entirety. Thus, as CCC accurately re-states the issue, what it seeks to prevent is not the operation of its contract with ISI, but rather "the State of New Jersey from superseding the contract to give ISI what may amount to a perpetual and exclusive right to distribute CCC's products in [the Eight States]."[22] Secondary Reply Brief at 3.

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[22] The suggestion that CCC was aware of the Franchise Practices Act at the time it entered into its contract with ISI ignores that facts that (1) the parties agreed that California, not New Jersey, law would govern the contract and (2) New Jersey has historically given effect to contractual choice-of-law clauses. *See, e.g., Instructional Systems*, 130 N.J. at 341; *Winer Motors, Inc.* v. *Jaguar Rover Triumph, Inc.*, 208 N.J.Super 666, 671-72 (App.Div. 1986); *Kalman Floor Co.* v. *Jos. L. Muscarelle, Inc.*, 196 N.J. Super 16, 21-22 (App. Div. 1984), *aff'd* 98 N.J. 266 (1985). *But see Instructional Systems*, 130 N.J. at 341-46, 367 (finding that, although "nothing indicates that CCC intended or agreed that New Jersey law would cover its activities in the sister states of New Jersey," New Jersey had sufficient interest to apply its law to 1984 Agreement and to supersede contractually agreed-upon choice-of-law-clause).

Conclusion

For the reasons set forth above, the motion for partial summary judgment is granted. Extraterritorial application of Franchise Practices Act constitutes a *per se* violation of the Commerce Clause. Accordingly, Count One of the Complaint is dismissed. An order accompanies this opinion.

Dated: 2 June 1993

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

INSTRUCTIONAL SYSTEMS, INC., Plaintiff,	CIVIL ACTION NO. 89-502 (AJL)
v.	AMENDED ORDER
COMPUTER CURRICULUM CORP., Defendant.	

This matter having come before the court by way of the motion of partial summary judgment pursuant to Fed. R. Civ. P. 56; and the court having considered the submissions of the parties and having heard oral argument, and for the reasons set forth in an Opinion, filed on 2 June 1993, as corrected, and for good cause shown,

IT IS, on this 25th day of June, 1993,

ORDERED, that the motion for partial summary judgment is granted; the New Jersey Franchise Practices Act (the "Franchise Practices Act"), N.J.S.A. § 56:10 *et seq.*, is found to violate the Commerce Clause of the United States Constitution, U.S. Const. Art. I, § 8, cl. 3, to the extent it is sought to be applied to commercial transactions outside of New Jersey, as explained in the Opinion filed on 2 June 1993 and corrected on this date; and it is further

ORDERED, that count one of the Complaint is dismissed with prejudice, insofar as it alleges that the defendant violated the Franchise Practices Act by not renewing the Reseller Agreement, dated 12 July 1984, between the defendant and plaintiff, with respect to Connecticut, Delaware, the District of Columbia, Maine, Maryland, New Hampshire, Rhode Island and Vermont; and it is further

ORDERED, that the Opinion, filed on 2 June 1993, is amended as follows:

Delete text under Conclusion on page 56 and insert the following:

> For the reasons set forth above, the motion for partial summary judgment is granted. Extraterritorial application of Franchise Practices Act constitutes a *per se* violation of the Commerce Clause. Accordingly, Count One of the Complaint is dismissed with prejudice, insofar as it alleges that CCC violated the Franchise Practices Act by not renewing the 1984 Agreement, with respect to Connecticut, Delaware, the District of Columbia, Maine, Maryland, New Hampshire, Rhode Island and Vermont. An order accompanies this opinion.

/s/
ALFRED J. LECHNER, JR., U.S.D.J.

SUPREME COURT OF NEW JERSEY
A-11/79 September Term 1991

INSTRUCTIONAL SYSTEMS, INC.,
a Corporation of the State of
New Jersey,

Plaintiff-Appellant
and Cross-Respondent,

v.

COMPUTER CURRICULUM CORPORATION,
a Corporation of the State of
Delaware,

Defendant-Respondent
and Cross-Appellant.

Argued May 4, 1992—Decided October 19, 1992

On certification to the Superior Court, Appellate Division, whose opinion is reported at 243 N.J. Super. 53 (1990).

Peter N. Perretti, Jr., argued the cause for appellant and cross-respondent (*Riker, Danzig, Scherer, Hyland & Perretti* and *Dunn, Pashman, Sponzilli, Swick & Finnerty*, attorneys; *David W. Garland, Jeanne M. Bratsafolis, Robert E.*

Rochford, *Warren S. Robins*, *Joseph Dunn*, *Anne M. Patterson*, and *Jeffrey J. Miller*, on the briefs).

Jay Greenfield, a member of the New York bar, argued the cause for respondent and cross-appellant (*McCarter and English*, attorneys; *Mr. Greenfield*, *Andrew T. Berry*, *Teresa L. Moore*, *Rosanne C. Kemmet*, *Debra Ann Livingston*, a member of the New York bar, and *Michael E. Gerber*, a member of the New York bar, of counsel; *Ms. Moore*, *Ms. Livingston*, and *Mr. Gerber*, on the briefs).

Michael J. Ferrara submitted a brief on behalf of *amicus curiae* Fair Franchising Coalition (*Greenberg, Ferrara, Covitz, Turitz, Harraka & Goldberg*, attorneys; *Jere W. Glover*, a member of the District of Columbia bar, of counsel).

The opinion of the Court was delivered by O'HERN, J.

This appeal requires us to adapt legislation enacted over twenty years ago on the model of franchise stereotypes, such as a fast-food outlet, an automobile dealership, or a gasoline service station, to the rapidly-evolving complexities of the computer industry and its various distribution channels. We hold that the contractual relationship between the producer of a computerized educational-learning system and its exclusive regional distributor, a business incorporated in New Jersey, sustains a finding of a "franchise" within the meaning of the New Jersey Franchise Practices Act, *N.J.S.A.* 56:10-1 to -15 (the Act). The Appellate Division held that the relationship between the producer and the New Jersey entity did not constitute a franchise because the producer had not granted the New Jersey entity a "license to use" its trade name or trademark within the meaning of the Act. *N.J.S.A.* 56:10-3a. However, the contract documents expressly conferred on the New Jersey entity both the right to use the

producer's "name, trademark and logo in its advertising, exhibits, trade shows, public relations materials and manuals," and the duty to use its "best efforts" to promote the producer's products. Although our second determination involves a much closer question, we hold that the evidence sustains the finding of a "community of interest" required under the Act to establish a franchise. *N.J.S.A.* 56:10-3a. We thus reverse the judgment of the Appellate Division.

I

BACKGROUND

A. Facts and Procedural History

For purposes of this appeal, we adopt generally the procedural history and the facts of the case as set forth in the brief of defendant, Computer Curriculum Corporation (CCC).

CCC is a Delaware corporation headquartered in Palo Alto, California. It produces and markets an integrated learning system that uses computer technology to teach and monitor a student's progress in such subjects as mathematics, reading, language skills, and computer-science education. From 1974 to 1989, plaintiff, Instructional Systems, Inc. (ISI), a New Jersey corporation with its primary place of business in New Jersey, has served as the exclusive distributor of products sold by CCC in the Northeast. ISI has done so pursuant to a series of written contracts negotiated between the principals of the two companies.

On July 12, 1984, CCC and ISI entered into the contract at issue, entitled "Reseller Agreement." Under that contract, CCC appointed ISI as the exclusive "reseller" of CCC products to certain categories of customers in Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island, Vermont, and Washington D.C. The contract

provided that the agreement "shall ... continue in effect until July 31, 1989."

In the fall of 1988, ISI proposed that CCC extend the 1984 Reseller Agreement for one more year. CCC declined to do so. CCC believed that ISI was spending a disproportionate amount of its efforts selling in three states—New Jersey, New York, and Massachusetts—and was practically ignoring the rest of its sales territory. From 1985 to 1987, ISI's sales in those three states accounted for only eleven percent of its total sales, notwithstanding the fact that thirty percent of the student population in ISI's territory resided there. In two states, Vermont and New Hampshire, ISI made no sales during that period. In Maine, ISI made no sales in either 1986 or 1987. In the District of Columbia, one of the principal population centers in ISI's territory, ISI's sales for the 1985-1987 time period were less than one percent of ISI's total revenues.

When CCC approached ISI about its allegedly poor sales performance in those states, ISI claimed that its only obligation was to meet certain territory-wide sale quotas. In CCC's view, ISI had told CCC "that it was none of CCC's business" within which territory ISI concentrated its sale efforts.

Instead of allowing the 1984 Reseller Agreement to lapse when it expired, CCC offered ISI a new two-year contract for the three states in which ISI had its major sales activity—New Jersey, New York, and Massachusetts. CCC decided to take over the marketing of its products in the former ISI territory. Following lengthy discussions, ISI and CCC entered into a new contract on January 30, 1989. On August 1, 1989, CCC began to distribute its products in the former ISI territory. ISI continues to sell CCC products in New Jersey, New York, and Massachusetts.

The same day that ISI executed the new agreement with CCC, ISI filed suit against CCC in the Chancery Division. The complaint alleged that the 1984 Reseller Agreement contemplated

renewal, that CCC had coerced ISI into signing the new contract, and that CCC had violated the Act by imposing "unreasonable standards of performance" on ISI. The complaint also set forth claims for breach of contract, breach of implied covenant, tortious interference with prospective economic advantage, unfair competition, unjust enrichment, and breach of fiduciary duty.

CCC removed the suit to the United States District Court for the District of New Jersey on the basis of diversity of citizenship. Following discovery, ISI moved for a preliminary injunction enjoining CCC from enforcing the 1989 agreement and for partial summary judgment on its claims under the Act. CCC made a cross-motion for summary judgment, arguing that if the Act could be used to enjoin it from terminating ISI's purported franchise in states other than New Jersey, the Act would violate the Commerce Clause of the United States Constitution. U.S. Const. art. I, § 8, cl. 3.

ISI responded to the cross-motion by moving before the District Court for an order remanding the state-law issues to the New Jersey courts under the *Pullman* abstention doctrine. See *Railroad Comm'n of Texas* v. *Pullman Co.*, 312 U.S. 496, 61 S. Ct. 643, 85 L. Ed. 971 (1941). The District Court retained jurisdiction over the case and "[a]pplication of the principles of the law determined by the state court to the facts of this case," but "administratively ... terminated" the matter and remitted to the New Jersey courts the following issues:

> (a) [w]hether the Act has extraterritorial reach beyond the State of New Jersey and, if so, to what extent; and
>
> (b) [w]hat are the definitions and standards of "community of interest," "license" and "place of business" under the Act[?]

After ISI protested that the limited scope of the remand instructions was tantamount to directing the state court to render an

advisory opinion, the court clarified its order. That order authorized the New Jersey court to determine "whether or not there is a community of interest between ISI and CCC," and "whether ISI has a place of business" within the meaning of the Act. The District Court acknowledged that the state court would have to consider the facts of the case in deciding those issues and whether the Act could be applied extraterritorially.

When the matter was returned to the Chancery Division, ISI filed a new complaint alleging that the 1984 Reseller Agreement had created a "franchise" and that CCC had violated the Act by failing to renew the agreement without "good cause" and by imposing unreasonable standards of performance. The complaint sought "a declaration of the rights and liabilities of CCC and ISI under their relationship," an order enjoining CCC from terminating its relationship with ISI, damages, attorneys' fees, and costs. Both parties agreed to submit the case to the Chancery Division based on the District Court's record and without further discovery.

The Chancery Division issued a declaratory judgment that the relationship between the parties constituted a "franchise" and that that relationship was subject to the Act.

The Chancery Division ruled first that the importance of New Jersey's interest in protecting its franchisees nullified the 1984 agreement's California choice-of-law provision. Next, the court found there could be "no other reasonable conclusion" but that CCC and ISI had "contemplated" that plaintiff would have a "place of business" in New Jersey as required by the Act for coverage. The court then found that CCC had granted to ISI a license to use its trade name. The court based that finding on the conclusions that the school districts buying CCC products had perceived ISI and CCC to be the same entities, and that CCC had "vouched" for ISI's competence by having ISI train customers to use CCC products.

The court found further that there was unequal bargaining power and sufficient mutual dependence between the parties to form

the Act's "community-of-interest" requirement. Finally, the court found that the Legislature had not sought to give the Act extraterritorial effect beyond New Jersey. Rather, it was the parties, by defining a market area in their contract which includes states beyond the State of New Jersey, who gave the Act the extraterritorial reach.

The Appellate Division reversed, holding that the 1984 agreement does not constitute a franchise within the meaning of the Act because CCC "did not grant a 'license' to ISI as that term is used within the Act's definition of 'franchise.'" *Instructional Systems, Inc.* v. *Computer Curriculum Corp.*, 243 N.J. Super. 53, 58 (1990). The Appellate Division declined to consider whether the Act, if it had been applicable to the relationship between CCC and ISI, could have been applied extraterritorially. *Id.* at 61-62.

We granted ISI's petition for certification, 126 N.J. 318 (1991). Because the Appellate Division had based its decision solely on the license issue, we asked the parties to brief the remaining issues of choice of law, place of business, community of interest, and extraterritoriality. We heard reargument on those issues. We now reverse.

B. Technical Background and Reseller Agreement

In order to understand this appeal more fully, we must attempt to understand something about which we know very little —computer technology. A computer is not like a manual typewriter, on which we can actually see the physical connection between input—manually pressing a key, and output—the hammer striking a sheet of paper. One who presses a few keys on a computer keyboard that produces information or text on a video-display screen is largely unaware of what actually occurs within the machine to allow the information to be presented. However, a rudimentary understanding of computer technology helps one to grasp the relationship between CCC and ISI.

There are three basic components involved in the computer process: hardware, operating-system software, and application software. All of those components have distinct responsibilities that must be carried out with precision and in harmony. *See* 11 *McGraw-Hill Encyclopedia of Science & Technology* 124–26 (7th ed. 1992) *(McGraw-Hill); Encyclopedia of Computer Science* 641–49 (1976).

Hardware, the most obvious component of the computer process, consists of all of the physical objects that make up a computer; *i.e.*, a central processing unit, or CPU (the part of the computer that contains the electronic circuits), a keyboard, a video display, and a printer. *See generally* Linda G. Christie & John Christie, *The Encyclopedia of Microcomputer Terminology* (1984) *(Microcomputer Terminology)* (defining computer-related terms). Operating-system software interacts directly with the hardware and tells the computer how to perform the most basic functions. For example, without a software-operating system, a computer would not know how to place a character on the video-display screen and would be nothing more than a useless mass of silicon and plastic. Simply stated, operating-system software turns the hardware into a usable machine. *See McGraw-Hill, supra,* at 125–26. The operating-system software often accompanies the computer's major hardware component, the CPU. *See Microcomputer Terminology, supra.*

Application software interacts directly with operating-system software to comprise the final set of instructions required to make a computer perform a given task. Application software ranges from "off-the-shelf" packages, such as familiar word-processing programs like WordPerfect, which may be purchased at the neighborhood-software store, to custom designed, user-specific programs. Application software does not interact with the computer hardware but interacts exclusively with the operating-system software. *See McGraw-Hill, supra,* at 125–26. Therefore, application software is usually designed to interact with one type of operating-system software. *Ibid.* Because of that limitation, the

computer industry has developed standard operating-system software packages that run with a great majority of computer hardware. Two of the most notable standard operating systems are "MS-DOS" and "UNIX."[1/] *See Time-Life, supra,* at 96–97.

The CCC computer-assisted learning system consists of hardware, operating-system software, and application software. The CCC system's hardware is the amalgamation of numerous physical components that CCC has assembled together into what it calls the "Microhost." The Microhost's operating-system software, also developed by CCC, is a modification of the UNIX operating system. CCC system's application software is essentially the heart of the CCC product line. CCC has spent over twenty years researching and developing an extensive library of educational-curriculum software, which CCC describes as "Courseware."

The CCC integrated-learning system reinforces what is being taught to the student in the classroom. Visualize a "computer laboratory" of students working at numerous computer terminals. When a student punches into the computer a four-digit identification number followed by the student's first-name, the words "Hello, Student ..." flash on the terminal screen. Each computer session begins where the student finished the previous day. When the student types an incorrect answer, the computer politely suggests "Try again." When the student finishes the lesson, the screen

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[1/] MS-DOS is the operating-system software that runs the IBM Personal Computer (or PC) family and was developed by Microsoft Corporation. See Time-Life Books, *Understanding Computers—The Personal Computer* 17 (1985) *(Time-Life).* That operating system, referred to as DOS, MS-DOS, or PC-DOS, has been shipped with every IBM-PC hardware unit since the release of the original PC in 1981.

UNIX is the operating-system software developed by AT&T. UNIX and MS-DOS are very different operating systems. One of the greatest distinctions between the two operating systems is in the development of application software that interacts with the two operating systems. The computer industry has created generally a much greater resource of application software to interact with the MS-DOS operating system. *Id.* at 96–97.

displays the student's results and the computer records the student's performance.

Students use the CCC computer-assisted instruction system to extend their classroom lessons and to enhance learning and performance. Teachers accompany their classes to the computer laboratory, where they help students understand the problems and relate the instructions from the classroom to the computer laboratory. Teachers need no expertise as computer operators or programmers. The teachers are trained on how the system works and are familiarized with the available software curriculum, or Courseware.

CCC is in large measure the creation of Dr. Patrick Suppes, formerly of Stanford University, who spent over two decades researching and developing the CCC system. Except in the Northeast, CCC markets, distributes, and sells its products directly to educational institutions throughout the United States.[2/] Over the past fifteen years, CCC has developed a distribution arrangement in the Northeast with Phyllis Kaminer (Kaminer), the President and CEO of ISI. Evidently, Kaminer developed some expertise in the field of education and computers, and, in 1972, became associated with a company known as Educomp of Connecticut. In her position at Educomp of Connecticut, Kaminer developed a relationship with CCC. Following Educomp of Connecticut's refusal to make an arrangement with CCC for the promotion of CCC products, Kaminer left Educomp of Connecticut and sought her own arrangement with CCC.

CCC entered its first distribution contract with Kaminer in 1975. At that time, Kaminer was the principal of a company known

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[2/] At one point, CCC distributed its products in the South through a company known as Southern Educational Media; however, CCC terminated that business relationship in the mid-1980s and currently acts as the distributor of its products in the South. In Canada, CCC distributes its products through a company known as Columbia Institute of Canada.

as Educomp of New Jersey, located in Tenafly, New Jersey. The 1975 agreement gave Educomp of New Jersey the exclusive right to market CCC products in the states of New York, New Jersey and Connecticut and in the region of Eastern Pennsylvania.[3] The 1975 agreement was to run until 1980.

The record suggests that sometime between 1975 and 1980, Kaminer changed the name of her company to ISI and moved the headquarters to Englewood Cliffs, New Jersey. In 1980, CCC entered into a new distribution agreement with ISI. The 1980 agreement gave ISI the "exclusive right to purchase or license the CCC products ... for purposes of selling, leasing or renting such products to the market in the States of Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island, Vermont and Washington D.C." The 1980 agreement was to run until 1984.

The 1984 agreement between CCC and ISI, labeled "ReSeller Agreement," contained many of the same provisions as the 1980 agreement. ISI highlights several provisions contained in the 1984 agreement that it deems relevant:

1. CCC conferred on ISI an exclusive right to sell and license CCC's products within ISI's territory.

2. CCC required ISI to use "its best efforts to develop a demand for and Resell the [CCC] Products within the Market ..."

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[3] The original language of the 1975 agreement stipulated that CCC was entering into a contract with "Educomp Corporation, a Connecticut Corporation, with its principal place of business at 196 Trumball Street, Hartford Connecticut." However, after Kaminer had received the document, she had the language changed to read "Educomp of New Jersey Inc., A New Jersey Corporation," and the address in Connecticut was stricken and replaced by an Englewood Cliffs, New Jersey address.

3. CCC obligated ISI to "devote all of its energies and resources to developing a demand for the [CCC] Products."

4. CCC prohibited ISI from selling any products competitive with CCC's products.

5. CCC required ISI to maintain at least four full-time sales representatives to promote and sell CCC's products.

6. CCC obligated ISI to "maintain adequate facilities ... to promote demand for and Resell [CCC's] Products."

7. CCC required ISI to promote CCC's products through "advertising and exhibition at trade shows, conventions and the like."

8. CCC authorized ISI to extend its use of the CCC name, trademark and logo in ISI's "advertising ... public relations materials and manuals."

9. CCC gave ISI the right to sublicense the CCC copyrighted Courseware.

10. CCC allowed ISI to receive sublicense fees from its customers for the CCC Courseware and to pay CCC license fees for each sublicense in accordance with a price schedule established by CCC.

11. CCC required ISI to prepare customers' sites for installations of the CCC product

in accordance with CCC specifications; CCC installed the products.

12. CCC required ISI to "establish and maintain a program for the benefit" of the users of the CCC products so that they may obtain training in the use and operation of the CCC products.

13. The agreement was to be interpreted in accordance with the laws of the State of California.

In ISI's view, under the terms of the 1984 agreement, it had the responsibility of locating customers, persuading them to purchase CCC's products, selecting the site at which the product was to be installed, and placing the purchase orders with CCC. Following CCC's installation of the product, ISI would train the teachers and instructors to use the product. Thereafter, ISI had a duty to follow-up with the customer to provide continuing training at those locations. Ninety-seven percent of ISI's revenue came from the sale of CCC's products.

In 1988, in an effort to remain competitive within the computer-assisted-instruction industry and to avoid product obsolescence, CCC decided to change the direction of its business. Around that time, CCC began negotiations with IBM to allow its application software, or Courseware, to run on the MS-DOS standard operating system. By allowing its Courseware to run on MS-DOS, CCC would increase the accessibility of its product line. Thus, such an arrangement would allow CCC's Courseware to run on the popular IBM Personal Computer family, thereby eliminating CCC's need to assemble and market its own Microhost hardware. Presumably, such an arrangement would allow CCC to market its products more competitively to smaller school districts because the smaller districts would not be "locked-in" to purchasing the CCC

Microhost, and could purchase a less expensive and more versatile IBM-PC instead.

CCC's efforts to change business directions caused CCC to reconsider its relationship with ISI. In 1989, CCC offered to ISI a new written agreement (the 1989 agreement) that modified the 1984 Reseller Agreement. That agreement reduced ISI's marketing territory to three states: New Jersey, New York, and Massachusetts. The balance of ISI's prior territory comprising Maine, New Hampshire, Vermont, Rhode Island, Connecticut, Delaware, Maryland, and the District of Columbia was taken over by CCC and has been marketed directly by CCC since August 1, 1989. The 1989 agreement eliminated ISI's exclusive right to sublicense the CCC Courseware in the assigned territory.

II

What is a "franchise" under the New Jersey Franchise Practices Act?

We now turn to the issue of whether the business relationship between CCC and ISI constitutes a franchise protected under the Act. CCC asserts that the 1984 agreement does not constitute a franchise because (1) CCC never granted to ISI a "license," as that term is contemplated under N.J.S.A. 56:10-3a; (2) there is no "community of interest" between CCC and ISI; (3) the parties did not "contemplate" that ISI would maintain a "place of business" within the State of New Jersey; and (4) ISI never maintained a "place of business" in the State of New Jersey. We address each of those arguments in turn.

Although franchise arrangements take many different forms,

> "in its simplest form, franchising involves a company with a product or service which arranges for a group of dealers to handle its distribution. The company with the product, product line or service is known as the franchisor, and the

dealers who acquire the right to sell the product or service exclusively are known as franchisees."

> [Ernest Gellhorn, *Limitations on Contract Termination Rights—Franchise Cancellations*, 1967 *Duke L.J.* 465, 465 n.1 (quoting Lewis & Hancock, *The Franchise System of Distribution* 1 (1963) (Gellhorn)).]

There are three general categories of business franchises:

> (1) *Product Franchises*, under which "a franchisee[ ] distribute[s] goods produced by the franchisor ... and which bear the franchisor's trademark. ... Typical product franchises include automobile and truck dealers, gasoline service stations, and soft drink bottlers."
>
> (2) *Package or Format Franchises*, under which "the franchisee is licensed to do business under a prepackaged business format established by the franchisor and identified with the franchisor's trademark. ... Examples of format franchises include fast food outlets and automotive products or services."
>
> (3) *Fractional Franchises*, under which "franchisees market a manufacturer's or supplier's trademarked products. In contrast to product or format franchises, the fractional franchisor exerts minimal control over the franchisee's business operations, and the franchisee often operates under [its] own trade name. Common fractional franchises include independent hardware stores ... that sell a variety of products [belonging to different manufacturers]."
>
> [Kevin S. Dittmar, *Foerster. Inc. v. Atlas Metal Parts—The Wisconsin Supreme Court Takes a Narrow View of the Dealer's Financial Interest*

Protected by the Wisconsin Fair Dealership Law, 1985 *Wis. L. Rev.* 155, 167-68 (footnotes omitted) (Dittmar).]

At common law, freedom of contract was the rule applicable to franchise agreements. Gellhorn, *supra*, 1967 *Duke L.J.* at 468: "The effects of termination were starkly simple—the franchisee would be ousted from the franchise, essentially forfeiting his investment .... The franchisor would then regain full control of the terminated business and would be free to begin a relationship with a new franchisee." *Dunkin' Donuts of Am. Inc.* v. *Middletown Donut Corp.*, 100 N.J. 166, 176 (1985) (citations omitted); *see also* Gellhorn, *supra*, 1967 Duke L.J. at 467 n.5 (describing the financial hardship suffered by a terminated beer distributor).

Recognizing that the marketplace was not necessarily the best protector of those franchisees with substantially-inferior bargaining power, this Court wrote:

> Where there is grossly disproportionate bargaining power, the principle of freedom to contract is non-existent and unilateral terms result. In such a situation courts will not hesitate to declare void as against public policy grossly unfair contractual provisions which clearly tend to the injury of the public in some way.
>
> [*Shell Oil Co. v. Marinello*, 63 N.J. 402, 408 (1973), *cert. denied*, 415 *U.S.* 920, 94 S. Ct. 1421, 39 L. Ed. 2d 475 (1974) (citing *Henningsen v. Bloomfield Motors, Inc.*, 32 N.J. 358, 403-04 (1960)).]

Franchising became a popular method of distribution in the late 1960s. 1 Gladys Glickman, *Franchising* § 2.01 at 2-3 (1969) (Glickman). As the popularity of franchising grew, concerns were raised about the degree of control the franchisor exercised over the

franchisee, in particular, the franchisor's power of "life or death" to terminate the franchise. *Id.* at 2-3 to 2-4.

In response to the growth of national franchising, the Federal Trade Commission (or FTC) began setting guidelines for franchises in the 1970s. *Id.* § 2.02[2] at 2-7 to 2-8. The FTC defines a "franchise" as "any continuing commercial relationship ... whereby ... a person (hereinafter 'franchisee') offers, sells, or distributes ... goods, commodities, or services which are: (1) [i]dentified by a trademark, service mark, trade name, advertising or other commercial symbol designating another person (hereinafter 'franchisor')." 16 *C.F.R.* § 436.2(a) (1992). The FTC definition requires further that the "franchisor exert[ ] or [have] authority to exert a significant degree of control over the franchisee's method of operation." *Ibid.*[4] In the "Guides to Compliance" accompanying the FTC franchising rule, the Commission states:

> The name which the parties give to their relationship is not relevant in determining whether the relationship is within the scope of the rule. Thus, a relationship described by the parties as a "franchise" will not be covered by the rule unless it meets the definitional criteria of the rule; conversely, a self-described 'distributorship' will be covered by the rule if the definitional elements are satisfied.
>
> [Glickman, *Franchising*, *supra*, § 2.02[2] at 2-8 n.7 (quoting *Final Guides to Compliance with Franchising Rule* § IA, 44 *Fed. Reg.* No. 166, p. 49966).]

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[4] H.R. 5233, the "Federal Fair Franchise Practices Act," has recently been introduced in Congress. The bill would adopt a more expansive definition of a franchise than under the present FTC definition. *See* Kim A. Goodhard, *Franchise Bills Would Have Broad Impact, Nat'l L.J.*, Aug. 3, 1992, at 21, 23.

Therefore, in determining whether a relationship constitutes a franchise, the FTC examines the entire course of dealings between the parties.

Prompted in large measure by the unfair practices of automobile manufacturers and major oil companies, New Jersey passed the Franchise Practices Act in 1971. N.J.S.A. 56:10–1 to –12. This Act was supplemented in 1977 with four sections, two of which specifically concern automobile franchises. See N.J.S.A. 56:10–7.1 and 56:10–13. In 1982, the Legislature passed the Motor Vehicle Franchises Act, N.J.S.A. 56:10–16 to –25 (now N.J.S.A. 56:10–16 to –29). The Franchise Practices Act (the Act) provides franchisees protection against indiscriminate terminations by prohibiting cancellation or non-renewal of franchises for other than good cause. The Act's supporters indicated that "[t]his bill gives neither the franchisor nor franchisee the upper hand. What it does, however, is to prevent arbitrary or capricious actions by the franchisor who generally has vastly greater economic power than the franchisee." Franchise Practices Act: *Hearing on A. 2063 Before the Assembly Judiciary Comm.*, 194th Leg., 2d Sess. 136 (1971) (*Hearing on A. 2063*) (Statement of Charles W. Davis, Executive Vice-President New Jersey Hotel/Motel Ass'n).

The Act defines a franchise as

> a written arrangement for a definite or indefinite period, in which a person grants to another person a license to use a trade name, trade mark, service mark, or related characteristics, and in which there is a community of interest in the marketing of goods or services at wholesale, retail, by lease, agreement, or otherwise.
>
> [N.J.S.A. 56:10–3a.]

However, not all franchisees are protected; the Act

> applies only to a franchise (1) the performance of which contemplates or requires the franchisee to establish or maintain a place of business within the State of New Jersey, (2) where gross sales of products or services between the franchisor and franchisee covered by such franchise shall have exceeded $35,000.00 for the 12 months next preceding the institution of suit pursuant to this act, and (3) where more than 20% of the franchisee's gross sales are intended to be or are derived from such franchise.
>
> [N.J.S.A. 56:10–4.]

III

Does the New Jersey Franchise Practices Act apply at all in view of the parties having chosen California law to govern the interpretation of their contract?

The threshold question is whether New Jersey law should govern this dispute. The 1984 Reseller Agreement contains a provision stipulating that the "[A]greement shall be construed and interpreted, and the legal relations created by it shall be determined, in accordance with the laws of the State of California." Ordinarily, when parties to a contract have agreed to be governed by the laws of a particular state, New Jersey courts will uphold the contractual choice if it does not violate New Jersey's public policy. *Winer Motors, Inc.* v. *Jaguar Rover Triumph, Inc.*, 208 N.J. Super. 666, 671–72 (App. Div. 1986); *Kalman Floor Co.* v. *Jos. L. Muscarelle, Inc.*, 196 N.J. Super. 16, 21–22 (App. Div. 1984), *aff'd o.b.*, 98 N.J. 266 (1985). That view is reflected in the *Restatement (Second) of Conflicts of Laws* § 187 (1969) (*Restate-*

ment), which provides that the law of the state chosen by the parties will apply, unless either:

> (a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or
>
> (b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which ... would be the state of the applicable law in the absence of an effective choice of law by the parties.

The exception set forth in part (a) of the *Restatement* approach does not apply because CCC is headquartered in California, and hence California law has a "substantial relationship to the parties." CCC argues that the exception under part (b) of the *Restatement* does not apply because New Jersey does not have a "materially greater interest" than California concerning ISI's distribution rights in states *other than New Jersey*. CCC argues that New Jersey has an interest in regulating only those franchise terminations that occur within its borders, but that when, as here, the alleged franchise is being terminated in states other than New Jersey, New Jersey has no interest in applying its law protecting the rights of franchisees.

CCC relies on *Carlos* v. *Philips Business Systems, Inc.*, 556 *F. Supp.* 769 (E.D.N.Y.), *aff'd*, 742 *F.*2d 1432 (2d Cir. 1983). In *Carlos*, a manufacturer of dictating equipment had failed to renew an exclusive-distributorship agreement with the plaintiff, who did business in New Jersey, Connecticut, and Ohio. The court found that the only states that had a "true interest" in the outcome of the litigation were those states in which the distributorship was

being terminated because "they would be the states which would bear any economic burdens associated with business failures occurring within their borders." *Id.* at 774 n.4. The court thus applied New Jersey law to determine whether the termination was valid in New Jersey, and Connecticut law to determine if the termination was valid in Connecticut. *Id.* at 774–77. The court declined to apply the franchise-protection acts of either New Jersey or Connecticut to the non-renewal in Ohio, which had no franchise protection act, stating:

> The court has not been cited to, nor can it find[,] any authority for the proposition that the New Jersey and Connecticut Legislatures purported to give this important legislation extraterritorial effect. Therefore, it declines to so apply them.
>
> [*Id.* at 777.]

CCC argues that because the issue here is the discontinuation of ISI's distributorship in Maine, New Hampshire, Vermont, Rhode Island, Connecticut, Maryland, Delaware, and the District of Columbia, New Jersey does not have an interest in this litigation, let alone one that is "materially greater" than California's or the states whose interests are affected.

Although a close question, we do not believe that the trial court erred in applying New Jersey law to the dispute between the parties. In *Winer Motors, supra*, 208 N.J. Super. at 671–73, the court recognized that the state in which the franchisee is located has a significant policy interest in governing the relations between the parties, and determined that the law of that state would apply rather than the law of the contractually agreed-on forum. There, the franchisee was located in Connecticut and the contract specified that New Jersey law would apply to disputes between the parties. The court declined to apply New Jersey law and determined that just as New Jersey would apply its local law to govern the relationship between an out-of-state franchisor and a New Jersey franchisee,

Connecticut would apply its law to govern the relations between an out-of-state franchisor and a Connecticut franchisee. *Id.* at 672–73.

In *Wright-Moore Corp.* v. *Ricoh Corp.*, 908 F.2d 128 (7th Cir. 1990), the court refused to apply a contractual clause that selected New York law as the governing law, when the franchisor was located in New York and the franchisee in Indiana. The court applied Indiana law, reasoning that "a franchisor, through its superior bargaining power, should not be permitted to force the franchisee to waive the legislatively provided protections, whether directly through waiver provisions or indirectly through choice of law." *Id.* at 132. The *Ricoh* case, like our case, involved a multi-state (indeed, national) franchise. Nonetheless, subject to Commerce Clause considerations to be discussed in Part VI, *infra* at ___ (slip op. at 58–65), the *Ricoh* court held that Indiana law governed the franchise relationship. Although New Jersey law contains no express provision against waiver of the Act's protection, that the Act's protection may not be waived appears to be a common assumption. *See Unif. Franchise and Business Opportunities Act* § 103, 7A U.L.A. 104 (Supp. 1992) (Uniform Act) ("A party to a franchise or business opportunity may not waive a right or benefit conferred, or avoid a duty imposed, by this [Act] ....")[5/]

That a franchisee's principal place of business in a given state will afford the franchisee the protection of that state's law in connection with all products sold by the franchisee is implicit in other decisions as well. See *Swan Sales Corp.* v. *Jos. Schlitz Brewing*, 374 N.W.2d 640, 644 (Wis. Ct. App. 1985) (because dealer did not do any business in Wisconsin, that state's franchise act could not be applied to Swan's overseas beer sales). Despite

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[5/] The Uniform Act was approved in 1987 by the National Conference of Commissioners on Uniform State Laws (NCCUSL). The NCCUSL thought that legislators drafting franchising laws would benefit from the guidance of a uniform act in the field in part because of the interstate nature of the franchise business. Uniform Act, *supra*, 7A U.L.A. at 105.

some contrary precedent, "[m]ost courts ... have held that the parties to a franchise agreement cannot avoid the franchise law of the state in which the franchisee is located by providing in their agreement that the laws of another state will govern." Thomas M. Pitegoff, *Choice of Law in Franchise Agreements*, 9 *Franchise Law Journal* 15, 19 (1989).

CCC contends that New Jersey does not have an interest in this litigation because no franchise is being terminated in New Jersey. CCC attempts to split the contract into sales that occur in New Jersey and sales that occur in other states. However, the purpose behind franchise-act legislation is that dealers geographically "situated" in a forum state are to be the "desired beneficiaries of the legislation in order to make their bargaining position more equal to manufacturers[']." *Bimel-Walroth Co.* v. *Raytheon Co.*, 796 F.2d 840, 843 (6th Cir. 1986). To strip away the spokes of a "hub-type" franchise would counter the purpose of such legislation.

To use a mundane example, assume that an automobile manufacturer gave a franchise to a dealer in Montvale, New Jersey to serve northern Bergen County, New Jersey as well as Rockland County, New York. Would we assume that the New Jersey Legislature would be indifferent to the dealer's plight if, after having made a substantial investment in the fixed plant and having created a market for the manufacturer's vehicle in Rockland County, the manufacturer, without good cause, took over the Rockland County market for itself? ISI's situation is not identical but is analogous. "Few franchises are intrastate," and were parties free to dispense with the protection afforded by franchise acts, any "large franchisor by insertion of a choice of law provision requiring the application of the franchisor's home state's law, could with a stroke of a pen remove the beneficial effect of the franchisee's state's remedial legislation." *Winer Motors*, *supra*, 208 N.J. Super. at 671–72. "We will reject even the parties' choice of New Jersey local law in order to preserve the fundamental public policy of the franchisee's home state where its statutes afford greater protection." *Id.* at 672; *see*

also Business Incentives Co. v. *Sony Corp. of Am.*, 397 F. Supp. 63, 67 (S.D.N.Y. 1975) (declining to apply a contractual provision that New York law would govern the dispute between New Jersey distributor and New York company that provided Sony products for distribution by the New Jersey company).

As the New Jersey Act and the cases interpreting it make clear, New Jersey has a strong policy in favor of protecting its franchisees. In this case, New Jersey has significant "contacts" with the transaction. The franchisee is located here and the majority of ISI's employees reside in New Jersey. The franchise-specific investments, referred to below, relate primarily to the assets in New Jersey and the goodwill developed for CCC by New Jersey residents. New Jersey would undoubtedly be the state of applicable law had no choice-of-law provision existed.

The Chancery Division reasoned that because ISI maintained a "place of business" in New Jersey and had met all other requirements of the Act, New Jersey had the overriding interest in the fair treatment of its franchisee. The court qualified its interpretation of New Jersey law to the extent that it actually conflicted with the law of sister-states. The record is sufficient to allow New Jersey law to apply.

IV

What is the appropriate standard of review?

Having determined that New Jersey law governs this dispute, we now address the scope of our review on the issues relating to the existence of a franchise. Although the parties have not briefed the issue before us, we note that in CCC's brief to the United States District Court, CCC posed the question thus: "Summary judgment for CCC is mandated if a reasonable juror could not find that ISI has a franchise subject to the Act." *See New Jersey Am., Inc.* v. *Allied Corp.*, 875 F.2d 58 (3d Cir. 1989) (affirming summary judgment); *George R. Darche Assocs.* v.

Beatrice Foods Co., 538 F. Supp. 429 (D.N.J. 1981) (granting summary judgment), *aff'd*, 676 F.2d 685 (3d Cir. 1982); *see also Cassidy Podell Lynch. Inc.* v. *SnyderGeneral Corp.*, 944 F.2d 1131, 1137 (3d Cir. 1991) (declaring whether relationship constitutes a franchise is a mixed question of fact and law).

Granted, there are cases that have held that the existence of a franchise is a question of law to be decided by a court. *See Kania* v. *Airborne Freight Corp.*, 300 N.W.2d 63, 70 (Wis. 1981) ("[I]n the absence of a claim of ambiguity, which might require extrinsic evidence, the construction of a written contract is only a question of law for the court."). However, we conclude that that proposition applies only when the entire relationship between the parties may be deduced from their written arrangements. *See Kinn* v. *Coast Catamaran Corp.*, 582 F. Supp. 682, 686 (E.D. Wis. 1984) (finding that written dealership agreement clearly and unambiguously conferred a non-exclusive distributorship); *see also Nebraska Im-Pruv-All Inc.* v. *Sass*, 247 N.W.2d 924, 926 (Neb. 1976) (stating that in absence of sufficient factual issues, interpretation of contract to determine existence of franchise is matter of law).

Here, the existence of the franchise is so closely related to the dispositive factual findings of "place of business," "license," and "community of interest" that we believe the appropriate standard is whether the evidence presented was sufficient to permit a factfinder to determine that the statutory requirements for the existence of a franchise were met. Although this case was decided on cross-motions for summary judgment, it arises before the Court as if from a plenary trial because the parties agreed that no further evidence would be presented to the Chancery Division.

V

Does the business relationship between CCC and ISI constitute a franchise protected under the New Jersey Franchise Practices Act?

A. Did the 1984 Reseller Agreement contemplate that ISI would maintain a place of business in New Jersey?

CCC argues that its relationship with ISI is not governed by the Act because ISI does not maintain a "place of business" in New Jersey as that term is contemplated by the Act. CCC argues that in order to satisfy the "place-of-business" requirement, the 1984 Reseller Agreement must have required ISI to conduct its business in New Jersey. CCC further contends that ISI had not established a place of business in New Jersey because ISI could have conducted its business at any location within its territory.

The Act applies only to a franchise "the performance of which contemplates or requires the franchisee to establish or maintain a place of business within the State of New Jersey." N.J.S.A. 56:10-4(1). According to the statute, "place of business" means:

> a fixed geographical location at which the franchisee displays for sale and sells the franchisor's goods or offers for sale and sells the franchisor's services. Place of business shall not mean an office, a warehouse, a place of storage, a residence or a vehicle.
>
> [N.J.S.A. 56:10-3(f).]

Thus, the statutory terms permit a franchisee to receive the Act's protection if performance of the franchisee's activities *either* contemplates *or* requires a New Jersey place of business. N.J.S.A.

56:10–4(1). Hence, a franchise would be governed by the Act whether the contract required a place of business in New Jersey or whether the parties reasonably anticipated that the franchisee would establish a New Jersey place of business. Therefore, the statutory condition is met if the parties "consider[ed] ... a fixed business location for the sale of the franchisor's products." *SnyderGeneral, supra*, 944 F.2d at 1145.

There was sufficient evidence to support a finding of fact that the 1984 Reseller Agreement "contemplated" that ISI would have a "fixed business location" in New Jersey. Since 1977, ISI has had a marketing facility in New Jersey. From 1977 to 1986, the marketing facility was located in Englewood Cliffs, New Jersey. ISI moved its operations to Hackensack, New Jersey in 1986. ISI specifically constructed its Hackensack facility so that CCC products could be displayed and demonstrated to prospective customers. To assist in those demonstrations, ISI purchased and installed CCC Microhost computer hardware. Over the years, ISI had used its marketing facilities to conduct hundreds of CCC product demonstrations for education professionals from all over the country. Besides conducting demonstrations, ISI also allows remote customers to "rent" its Microhost computers via a telephone-line connection from Hackensack to the remote customer site.

For a franchisee to have a "place of business," the statute requires that the franchisee "display[ ] for sale and sell[ ] the franchisor's goods or offer[ ] for sale and sell[ ] the franchisor's services." N.J.S.A. 56:10–3(f). The statute provides further that "an office, a warehouse, a place of storage, a residence or a vehicle" do not qualify as a "place of business." *Ibid.* The latter is the more significant aspect of the "place of business" requirement because it ensures that only those businesses that operate as genuine franchises will obtain the protection of the Act. "'This [requirement] ... means there must be a sales location in New Jersey. Mere distribution through an office or warehouse would not qualify.'" *Greco Steam Cleaning, Inc.* v. *Associated Dry Goods Corp.*, 257

N.J. Super. 594, 598 (Law Div. 1992) (quoting William J. Sweeny, *Applying Franchise Act to Terminated Distributors*, 125 N.J.L.J. 680 (1990)).

CCC argues that ISI does not satisfy the "place of business" requirement because it merely maintains an "office" in New Jersey, which is specifically excluded by the terms of N.J.S.A. 56:10-3(f). Relying on *Darche*, *supra*, 538 F. Supp. 429, CCC asserts that a New Jersey sales office is not a "place of business," even when used to supervise sales calls made throughout a multi-state territory. In *Darche*, the plaintiff was an independent contractor serving as a representative for the defendant food manufacturer. The plaintiff had a ten-state territory, but only one "New Jersey office location from which it supervised its own employees as they rode circuit through its territory soliciting orders." *Id.* at 431. The court held as a matter of law that the New Jersey sales office was not a "place of business," and therefore granted the defendant summary judgment. *Id.* at 434.

According to CCC, the "place of business" requirement means a specified location from which the franchisee, by prominently displaying the franchisor's goods as if they were its own, creates the public perception that it is not merely a seller of the franchisor's goods but is in fact part of a closer, "special relationship"—one unified organization. *See Finlay & Assocs.* v. *Borg-Warner Corp.*, 146 N.J. Super. 210, 219 (Law Div. 1976) (discussing special relationship between the parties as it relates to licensing), *aff'd on other grounds*, 155 N.J. Super. 331 (App. Div.), *certif. denied*, 77 N.J. 467 (1978). CCC would limit the "places of business" that are protected under the Act to the familiar franchise prototypes—the McDonald's restaurants, the Midas Muffler shops, the Buick dealerships, and comparable showrooms or retail outlets.

That ISI is not the same type of establishment as a prototypical franchise is undisputed. Unlike the franchise prototype, the consumer of CCC's products is not the general patron who walks

in off the street as if to buy a car or hamburger. Thus, ISI has no free-standing highway facility that is dedicated exclusively to displaying CCC's goods. Instead, ISI has only *one* facility—its headquarters office located on the sixth floor of a commercial office building in Hackensack. From that office ISI manages its entire operation.

CCC argues that such an office does not constitute a "place of business." But there is more to the New Jersey Franchise Practices Act than the prototypes of hamburger stands. *See Morgan* v. *Air Brooks Limousine, Inc.*, 211 N.J. Super. 84 (Law Div. 1986). (Although that case involved the Consumer Fraud Act, N.J.S.A. 56:8–1 to –48, it presupposed that a limousine service company could constitute a franchise albeit there was no specific discussion of the "place of business" requirement.)

The ISI Hackensack facility is much more than a mere sales office or warehouse. That location is a 6,000 square foot facility (about the size of three conventional courtrooms). One can demonstrate a computer-software system only by installing it and using it. ISI's Hackensack facility is equipped with a demonstration room modeled to simulate the classroom "laboratory." There, customers may experience the feeling of how the system would function in an actual school-room setting. ISI has been giving more than one hundred demonstrations a year at its Hackensack facility. Although some ISI customers have visited installation sites and have received demonstrations outside of New Jersey, that fact does not detract from the reality that the Hackensack facility is more than just an office.

In short, the record sustains the trial court's finding that ISI set up a marketing facility in Hackensack where its customers, education professionals, can inspect the CCC computer system and receive a sales demonstration of the operation of its complex product. ISI's Hackensack facility thus could be found to constitute a "place of business" under the Act.

B. Does the record support the trial court's finding that ISI has been granted a "license"?

Before a party may be deemed a franchisee subject to the Act's protections, it must show that it had been granted "a license to use a trade name, trademark, service mark, or related characteristic[ ]." N.J.S.A. 56:10-3a. Arguably, the statutory language "license to use a trademark" is broad enough to include the act of a trademark owner granting restricted permission to use its name in the grantee's advertising. Without that permission the grantee would be infringing on the grantor's right in the trademark. Indeed, legislators were not moved to limit the statute's wording despite the warning of an opponent of the bill who stated that the definition "is all-inclusive, and would embrace every business arrangement where a trademark or trade name is used." *Hearing on A. 2063, supra*, at 3 (testimony of Peter Dorn, Secretary of the New Jersey State Chamber of Commerce).

But it is obvious that not every grant of permission to use a trademark in the sale of goods or services is a "license" within the meaning of the Franchise Act. For example, a department store that sells brand-name clothing or television sets cannot realistically market those products without using the distinctive name and trademark of the manufacturer.

Setting aside the "community-of-interest" requirement, even if fifty percent of the department store's total revenue were derived from the sale of a particular brand of product, that circumstance would not render the arrangement a "license" within the meaning of the Act simply because the distributor is permitted to use the manufacturer's name to market the products. To define a "license" otherwise might convert every distributorship into a franchise. As the Third Circuit said in *Colt Industries, Inc.* v. *Fidelco Pump & Compressor Corp.*, 844 F.2d 117, 120 (1988), "if this limited agreement constitutes a license to use a trademark, then any

business selling a brand name product would, under New Jersey law, necessarily be considered as holding a license."

The Act's "license to use" requirement does not encompass a definition of "license" in the word's broadest sense, that is: "Permission to do something [that] without the license would not be allowable." *Black's Law Dictionary* 829 (5th ed. 1979) (citing *Great Atl. & Pac. Tea Co.* v. *City of Lexington*, 76 S.W.2d 894, 896 (Ky. Ct. App. 1934)). Instead, the term "license" as used in the context of the Act constitutes a more narrowly-defined type of Entitlement. In the language of *Finlay, supra,* the term "license" means "to use as if it is one's own. It implies a proprietary interest ...." 146 N.J. Super. at 219. At a minimum, the term "license" means that the alleged franchisee must use the name of the franchisor "in such a manner as to create a reasonable belief on the part of the consuming public that there is a connection between the ... licensor and the licensee by which the licensor vouches, as it were, for the activity of the licensee." *Neptune T.V. & Appliance Serv., Inc.* v. *Litton Sys., Inc.*, 190 N.J. Super. 153, 160 (App. Div. 1983).

In *Finlay, supra,* no license was found because the distributor had not conducted business under the manufacturer's name. 146 N.J. Super. at 220. So too in *Colt Industries, supra,* no license was found because plaintiff had been prohibited from using the defendant's name as part of its own. 844 F.2d at 120. In *Neptune T.V., supra,* the court found the presence of a license, but only because the plaintiff had held itself out as an "authorized Litton service source." 190 N.J. Super. at 156-57.

CCC contends that it did not grant ISI a "license" as that term is used in the Act. In response, ISI points to section 6.02 of the 1984 Reseller Agreement as expressly authorizing use of the trademark:

> ISI shall use its best efforts to maintain and promote CCC's name, trademark and logo on the Products. ISI is autho-

> rized, so long as this Agreement is in effect ... to use CCC's name, trademark and logo in its advertising, exhibits, trade shows, public relations materials and manuals as the same relate to the Products.

CCC replies that the rights granted under section 6.02 are so limited that the relationship does not satisfy even the broadest definition of license.

That ISI does not use CCC's name as its own is true. ISI has always operated under its own trade name, and admits that it does not use CCC's name on its stationery, business cards, or on any business signs. However, as in *Neptune T.V.*, ISI has established a relationship with CCC that is quite different from that of a department store that sells Apple or IBM computers. Section 6.02 of the 1984 Reseller Agreement *required* ISI to "*use its best efforts* to maintain and *promote* CCC's name, trademark and logo on the Products" (emphasis added). The CCC computerized-educational-learning system is not an "off-the-shelf" product that can be purchased at the neighborhood-appliance store. Rather, it is a unique combination of hardware and software whose identity is integrally related with that of ISI. Significantly, the 1984 Reseller Agreement prohibited ISI from selling *any products* competitive with CCC products. Moreover, CCC prohibited ISI from developing or designing any products that might compete with CCC's products. Furthermore, CCC obligated ISI to educate and train users of CCC products on a continuing basis. Surely, a factfinder could find the presence of the *Neptune T.V.* criteria here. To repeat the requirements of *Neptune T.V., supra*:

> [A] hallmark of the franchise relationship is the use of another's trade name in such a manner as to create a reasonable belief on the part of the consuming public that there is a connection between the trade name licensor and the licensee by which the licensor vouches, as it were, for the activity of the licensee in respect of the subject of trade name. See *Susser* v. *Carvel Corporation*, 206 F. Supp.

636, 640 (S.D.N.Y. 1962), aff'd 332 F.2d 505 (2d Cir. 1964), app. dism. 381 U.S. 125, 85 S. Ct. 1364, 14 L. Ed. 2d 284 (1965) in which the court explained that

> ... the cornerstone of a franchise system must be the trademark or trade name of a product. It is this uniformity of product and control of its quality and distribution which causes the public to turn to franchise stores for the product.

[190 N.J. Super. at 160.]

To transpose the words of *Neptune T.V.*, "We are satisfied that this hallmark was present here since by [CCC's] designation of [ISI] as an [exclusive distributor] and its [requirement]" that ISI maintain and promote CCC's name, trademark, and logo, CCC "gave its imprimatur to [ISI's] business enterprise in respect of [CCC's] product and induced the consuming public to expect from [ISI] a uniformly acceptable and quality controlled service endorsed by [CCC] itself." 190 N.J. Super. at 160–61.

Our dissenting members view the *Neptune T.V.* standard as insufficient to create a franchise relationship; they would insist that the identities of the two be merged; they look for an *alter-ego* relationship on the model of the franchise stereotypes—the McDonald's restaurants. That standard would require that such a business operate under the manufacturer's name before it fits the franchise definition. However, the inclusion of independently-named businesses is implicit in the Act's definition of franchise by the Act's limitation to a franchise "where more than 20% of the franchisee's gross sales are intended to be or are derived from such franchise." N.J.S.A. 56:10–4(3). Therefore, if only a "mirror-image" relationship could constitute a franchise, the Legislature would have added a superfluous requirement in the Act that the franchise sales constitute twenty percent of the entire business. The addition of that language, "more than 20%" of gross sales, seems to contemplate the creation of the "fractional franchise" described

in Part II, *supra* at ___ (slip op. at 18), under which the franchisee operates under its own unique trade name.

Even were we to seek an alter-ego standard for the franchise-license requirement, the record is replete with evidence that such a merger of identity actually existed. ISI's reputation throughout the Northeast has always been exclusively as a CCC distributor. If a customer in the Northeast wanted CCC products, it could find them only through ISI. CCC explicitly promoted ISI as its exclusive distributor. Training of customers on CCC products occurred through ISI. Any purchaser could have reasonably perceived that a "special relationship," *Finlay, supra,* 146 N.J. Super at 219, existed between ISI and CCC. Indeed, one member of the educational community, Brother William L. Lambert, remarked, "Although ISI appears to be a separate company from CCC, I and the educational community throughout the Northeast have always dealt with ISI as a virtual alter ego of CCC with respect to the purchase and use of CCC products."

Certainly, ISI is not CCC. Nonetheless, we are satisfied that the trial court had sufficient evidence to find that the relationship between ISI and CCC satisfied the *Neptune T.V.* standard: "Under these circumstances ... the extent of [CCC's] authorization to [ISI] to use the [CCC] name was sufficient to constitute a license as contemplated by the Act." 190 N.J. Super. at 161.

C. Does the record support the trial court's finding that ISI has a "community of interest" with CCC?

As noted at the outset of our opinion, the ambiguous "community of interest" inquiry is the most problematic issue in this case. The community-of-interest requirement addresses the inequality of bargaining power between the parties and is critical in distinguishing franchises from other types of business relationships. Nevertheless, only one New Jersey state court, in *Neptune T.V.*,

supra, has discussed the appropriate definition of community of interest. The court in *Neptune T.V.* found that the community-of-interest inquiry emphasizes the "vulnerability of the alleged franchisee to an unconscionable loss of his tangible and intangible equities." 190 N.J. Super. at 165. Because the plaintiff in *Neptune T.V.* lacked those features, that court, after ruling there had been a "license to use a trademark," found that the business relationship did not constitute a franchise. *Id.* at 167.

CCC argues that it does not share a community-of-interest with ISI. Relying on *New Jersey American, supra*, 875 F.2d 58, CCC contends that what makes the true franchisee unique and in need of the Act's protection is the vulnerability that arises because the franchisee is required to make substantial *franchise-specific* investments "that are ... valuable [only] if [the franchisee] remains a licensee" of that particular franchise. *Id.* at 62. Usually those investments are tangible capital investments, such as "a building designed to meet the style of the franchise, special equipment useful only to produce the franchise product, and franchise signs." *Ibid.* For example, McDonald's franchisees were required for many years to purchase and install "Golden Arches," which were of little value if the franchise were lost. Franchise-specific investments may also constitute intangible assets, such as the business goodwill associated with operating under the franchisor's name. *Ibid.*

The Act's concern is that once a business has made substantial franchise-specific investments it loses all or virtually all of its original bargaining power regarding the continuation of the franchise. Specifically, the franchisee cannot do anything that risks termination, because that would result in a loss of much or all of the value of its franchise-specific investments. Thus, the franchisee has no choice but to accede to the demands of the franchisor, no matter how unreasonable those demands may be. *Id.* at 62–63.

CCC argues that ISI has not placed itself in the vulnerable position of a genuine franchisee because it has not made substantial franchise-specific investments. CCC claims that ISI presented no

evidence that it has made non-transferable capital investments in buildings, equipment, signs, or anything else specific to CCC. In particular, CCC points to the following facts in support of its position:

- ISI's only office is an ordinary commercial office building in Hackensack; if terminated, ISI could use that office for many types of businesses or sublease it to some other party.

- ISI does not maintain any CCC products in its inventory, so there is no possibility that ISI would have stranded inventories if terminated. Ordinarily, ISI does not order products from CCC until it already has a sales order from an end user.

- ISI has not invested in any signs to identify its office as that of a CCC "franchisee." [ ]ISI does not put the CCC logo or trademark on its office door or directory.

- While ISI has purchased some CCC equipment and software for its own use (that is, for demonstration purposes or to provide timesharing services), the investment is minimal, easily transferable, and [ ]was not required by the Reseller Agreement.

Although acknowledging that ISI has developed goodwill for CCC and has benefitted CCC in that respect, CCC argues that ISI's goodwill investments are not of the type that the Act protects. CCC relies on *New Jersey American, supra,* for the proposition that the Act is concerned only with goodwill investments that are franchise-specific in that the goodwill is tied to and dependent on the continued use of some sort of asset unique to the franchise, such as the franchisor's trademark or the franchise place of business. 875 F.2d at 62.

To develop goodwill generally for a product cannot be enough to create a community of interest. Otherwise, any licensee distributing a brand-name product could claim it has a community of interest with its supplier. For example, a department store selling Sony name products could claim a community of interest with the manufacturer despite the fact that the department store's goodwill investments are not intimately tied to the manufacturer and therefore lack the economic character of genuine franchise investments.

As noted, the leading New Jersey case that interprets the "community of interest" standard is *Neptune T.V., supra,* 190 N.J. Super. 153. There, an appliance-repair business entered into a service contract with a manufacturer of microwave ovens whereby it became an "authorized Litton service source" for Litton ovens. *Id.* at 156. In addressing whether a community of interest existed between the parties, the court focused on the "context of the nature of franchising and the abuses to which this form of business enterprise is singularly susceptible." *Id.* at 161. The court found that the community-of-interest standard "is based on the complex of mutual and continuing advantages which induced the franchisor to reach his ultimate consumer through entities other than his own which, although legally separate, are nevertheless economically dependent upon him." *Id.* at 163.

Returning to the conceptual framework of *Shell Oil, supra,* 63 N.J. 402, and the Act's original purpose, the court concluded that what characterizes the community of interest is the potential for abuse that is triggered when the "reputation and good will of the network, created primarily by the efforts of each of the individual franchisees, passes back to the franchisor without compensation to the franchisee." *Neptune T.V., supra,* 190 N.J. Super. at 164. The court summarized its views of the "broad, elastic and elusive" concept of community of interest as reflecting a "symbiotic character of a true franchise arrangement and the consequent vulnerability of the alleged franchisee to an unconscionable loss of his tangible and intangible equities." *Id.* at 165. The Third Circuit recently echoed that reasoning: "[C]ommunity of interest exists

when the terms of the agreement between the parties or the nature of the franchise business requires the licensee, in the interest of the licensed business's success, to make a substantial investment in goods or skill that will be of minimal utility outside the franchise." *SnyderGeneral, supra,* 944 F.2d at 1143.

The *Neptune T.V.* court concluded that no community of interest existed between the parties in that case because their relationship "lacked ... the symbiotic character of a true franchise arrangement." 190 N.J. Super. at 165. Although the contract had authorized Neptune T.V. to represent and hold itself out as an "authorized Litton service source" in its advertising, letterheads, calling cards, and service vehicle markings, no community of interest existed because Litton's sole interest in the repair business was that Neptune perform the repairs in a satisfactory manner. *Id.* at 167. Litton had no interest in the volume of plaintiff's business, and its own interests were best served if its products required as few warranty repairs as possible. *Ibid.* Litton did not profit from nor had it performed its business through the repair operations, and Neptune did not contribute toward building Litton's business. *Ibid.* Furthermore, Litton's business accounted for only thirty-eight percent of Neptune's income. *Id.* at 157. Hence, Neptune lacked an independent and continuing financial interest in Litton's business and was not particularly susceptible to abuse as a result of any inequitable-financial leverage between the parties. *Id.* at 167.

Because the New Jersey Legislature had not defined "community of interest" in the Act, the *Neptune T.V.* court looked to other jurisdictions' interpretation of the community-of-interest requirement. The fullest discussion of that requirement is found in *Ziegler Co.* v. *Rexnord, Inc.*, 407 N.W.2d 873 (Wis. 1987), *reh'g granted on other grounds*, 433 N.W.2d 8 (Wis. 1988). In that case the community-of-interest requirement was part of Wisconsin's Fair Dealership Law. See Wis. Stat. § 135.025(3) (1991). In *Ziegler*, the court said that "[t]he legislature consciously defined the phrase community of interest to encompass an extraordinarily diverse set of business relationships not limited to the traditional franchise. ...

'[I]n determining whether a dealership exists, courts should not focus solely on the telltale trappings of the traditional franchise.'" *Id.* at 878 (quoting *Bush* v. *National School Studios, Inc.*, 407 N.W.2d 883, 890 (Wis. 1987)).

The *Ziegler* court concluded that although the percentage of income derived from a particular supplier is an important indicator of a community of interest, the community-of-interest requirement "cannot be reduced to a mathematical equation." *Ibid.* Rather, one guidepost to determine the existence of a community of interest is whether there is a "continuing financial interest" between the companies. *Ibid.* The court stressed that that "requirement contemplates a shared financial interest in the operation of the dealership or the marketing of a good or service." *Ibid.* In addition, a community of interest is shown by "interdependence" between the parties, which refers to the "degree to which the dealer and grantor cooperate, coordinate their activities and share common goals in their business relationship." *Id.* at 879. Thus, a dealer must "demonstrate a stake in the relationship large enough to make the grantor's power to terminate, cancel or not renew a threat to the economic health of the [dealer's business]." *Ibid.*

States with franchise-practice acts comparable to the New Jersey Act have employed similar definitions of community of interest. For example, Washington's Franchise Investment Protection Act defines a community of interest as "a continuing financial interest between the franchisor and the franchisee in the operation of the franchise business." *See* Wash. Rev. Code 19.100.010(2) (1991). In *Lobdell* v. *Sugar 'N Spice, Inc.*, 658 P.2d 1267 (Wash. Ct. App. 1983), the court found the requisite community of interest between a company that had been granted a candy distributorship for certain counties and the seller of those distributorships. The parties' agreement evidenced a sufficient continuing financial interest in the resale of the merchandise to prove a community of interest because it contained an agreement to purchase trade-name merchandise as well as a supply contract for a definite term. *Id.* at 1274. In addition, the distributor's financial

interest was evidenced by its contractual obligation "to maintain an ample supply of and diligently promote the company products." *Ibid.*; *see also Chase Manhattan Bank, N.A. v. Clusiau Sales & Rental, Inc.*, 308 N.W.2d 490, 492 (Minn. 1981) (finding a sufficient community of interest under Minnesota franchise act between a muffler company and an exclusive dealer when the dealer sold and installed mufflers and tail pipes according to the manufacturer's specifications); *Martin Investors, Inc.* v. *Vander Bie*, 269 N.W.2d 868, 874–75 (Minn. 1978) (finding a sufficient community of interest under Minnesota franchise act between a computer-service company that matched the needs of potential borrowers to potential lenders and a consultant who sold the system, when the computer service company had a contractual right to one percent of the proceeds of each loan placed by the consultant).

The interpretations of community of interest suggested by the *Neptune T.V.* and *Ziegler* courts are similar. Both courts look beyond the "telltale trappings of the traditional franchise." *Ziegler, supra*, 407 N.W.2d at 878. In *Neptune T.V.*, the court suggested considering whether a "symbiotic relationship" exists between the parties. That analysis is similar to the "interdependence" requirement urged by the *Ziegler* court and takes into account the extent of the licensor's control and the licensee's economic dependence discussed by other courts. *See SnyderGeneral, supra*, 944 F.2d at 1140. In addition, the "continuing financial interest" requirement articulated in *Ziegler*, by emphasizing that the franchisee "demonstrate a stake in the relationship large enough to make the grantor's power to terminate, cancel or not renew a threat to the economic health of the person," *Ziegler, supra*, 407 N.W.2d at 879, echoes the extent of the franchise-specific investment discussed by other courts as a hallmark of the franchise relationship. *See New Jersey American, supra*, 875 F.2d at 62.

CCC's experts, Professors Janusz A. Ordover and Carl Shapiro, emphasize the transferability and invulnerability of ISI's franchise-specific investments. The joint declaration of Professors

Ordover and Shapiro maintains that in order to conclude that ISI is a franchise, one must find that ISI made specific investments in CCC products that are "intimately tied" to a license granted by CCC. Professors Ordover and Shapiro aver that all investments made in the furtherance of a business enterprise do not necessarily rise to the standard of franchise-specific investments. They describe ISI's investments as "relationship investments," which are not sufficient to give rise to an inference of the existence of a franchise because they are not "vulnerable to opportunistic behavior by CCC" and are not "intimately tied to ISI's status as a licensee."

Professors Ordover and Shapiro reason further that the training of ISI's personnel, although an investment, is transferable to non-CCC products. They assert that ISI's goodwill investments in CCC will not be lost in the event of a termination, because ISI has always operated under its own name and its customers are aware of its independent relationship. Thus, the Professors reason that ISI is not a franchise because ISI has made merely the typical investments that a distributor must make in order to be "knowledgeable about a manufacturer's products that the distributors sell."

Despite the affirmations of CCC's experts, countervailing evidence was submitted to the trial court that suggests ISI has made franchise-specific investments. For example, the Microhosts that ISI purchased from CCC for demonstrating CCC's software and Courseware involved an investment of approximately $100,000. In the event of a termination, ISI would not be able to resell the Microhosts because it would be prohibited from licensing the CCC software and Courseware, and without the CCC software and Courseware the Microhosts are essentially useless. In addition, if terminated by CCC, ISI has no alternative line of products that it could substitute and sell in place of the CCC product line. For close to twenty years, ISI has persuaded its customers to choose the CCC system. The goodwill and contacts that Professors Ordover and Shapiro believe ISI could continue to exploit would vanish in the event of a termination. ISI argues that had it lost its status as a CCC distributor, ISI's competitors, including CCC, would deni-

grate ISI with references to its prior endorsement of the CCC product line. ISI argues that to sell CCC products in New Jersey, New York, and Massachusetts, and at the same time sell competitive products throughout the Northeast would be impossible.

ISI emphasizes the many "sunk investments" that it has made in the sale of CCC products that are non-transferable. In particular, ISI recites the following as "sunk investments:" at least $250,000 for the purchase of Microhosts and Microhost upgrades; at least $30,000 for the purchase of CCC hardware ("Graphics Servers") that ISI has given to potential customers as an incentive for future purchases of CCC products; the purchase of numerous CCC computer terminals that ISI has donated to school districts as an incentive for future purchases of CCC products; the cost to ISI of conducting studies for many school districts with respect to the use of CCC products. ISI views all those investments as non-transferable.

ISI asserts that the most critical asset in the form of goodwill it has developed for CCC's benefit is the "installed base of clients" in the Northeast. Rarely, argues ISI, will a school district switch from one integrated-learning system to another. Therefore, ongoing profits result from the customer base continually renewing their licenses and upgrading or expanding their systems.

ISI submitted confidential documents of the Kidder-Peabody Company, CCC's exclusive financial advisor, to the trial court, which we will not discuss in detail. Those documents described CCC's Courseware as "the industry standard." That analysis noted that ninety-five percent of CCC's customers renew their curriculum leases each year and that over the years most customers have expanded their systems. That confidential information emphasized further that "CCC currently has an installed base of more than 300 systems and 13,000 terminals in 1,000 schools nationwide, which the company estimates constitutes a fifty-five percent market share

of the entire [computer assisted instruction] industry." That report describes CCC as having "a dominant market system."

ISI argues that it is vulnerable to CCC's opportunistic behavior because all of the future profits that are generated from the installed base in the Northeast, with the exception of the states of New York, New Jersey, and Massachusetts, will accrue to CCC. Moreover, CCC will reap the benefit in those states of all the goodwill and various projects that ISI has undertaken to generate additional sales.

ISI's and CCC's interdependence is evidenced in various ways. CCC controlled ISI's business by obligating ISI to "direct all of its energies and resources to developing a demand for the [CCC] products," and by prohibiting ISI from developing or designing any products that might compete with CCC products in any location. Therefore, ISI was unlike a department store that could sell both Sony and Zenith televisions or market both Apple and IBM computers. ISI sold only one computer-assisted-learning system--CCC's. Hence, ISI could develop only a clientele that was wedded to the CCC product-line.

CCC required ISI to maintain at least four full-time sales representatives and to maintain adequate facilities to promote and sell CCC's products. ISI was required to submit monthly-sales-forecast reports, and CCC retained the right to monitor ISI's performance by inspecting ISI's books. CCC trained ISI marketing personnel and imposed restrictions on the way that ISI could market its supplemental products. CCC also controlled the quality of ISI's services by requiring ISI to prepare the customer site for installation in accordance with CCC specifications, and to maintain training programs for CCC product users.

In addition, ISI and CCC jointly cooperated in sales, marketing, and maintenance activities. ISI and CCC personnel jointly represented CCC products at educational conventions. CCC supplied ISI with brochures and with information regarding

potential customers within its territory. Both CCC and ISI jointly cooperated to resolve maintenance problems and shared costs associated with model-demonstration projects for prospective customers. CCC's promotional literature described ISI's Hackensack office as a "CCC regional office." As noted, the evidence revealed that ISI customers considered ISI and CCC as synonymous.

Finally, CCC prohibited ISI from selling any products which are competitive with CCC's products. CCC required ISI to use its "best efforts" to sell CCC's products. ISI was obligated to use "all of its energies and resources to developing a demand" for CCC's products. CCC granted ISI the right to sublicense the CCC copyrighted Courseware. And perhaps most important, ninety-seven percent of ISI's revenue came from the sale of CCC's products.

In the light of this record, the CCC-ISI relationship differs markedly from that described in *Neptune T.V., supra,* 190 N.J. Super. 153, in which the purported franchisee repaired the products of appliance manufacturers. Furthermore, unlike this case, the appliance repair service in *Neptune T.V.* was fully transferable. Nor is the CCC-ISI relationship like the relationship in *Colt Industries, supra,* 844 F.2d 117, in which the purported franchisee had a non-exclusive distributorship and was subject to little or no control by the manufacturer. Nor is the CCC-ISI relationship like the relationship in *New Jersey American, supra,* 875 F.2d 58, where the distributor used many suppliers of brake linings. Finally, the relationship in this case differs from the one in *SnyderGeneral, supra,* 944 F.2d 1131, where the distributor's air conditioning sale and service business was fully transferable. The distributor in *SnyderGeneral* could sell and repair other brands of air conditioners as well as other similar refrigeration or heating equipment.

Because of the extraordinary and intricate relations that arise in the distribution of computer products, a "close symbiotic relationship" arises almost of necessity between manufacturers and

distributors or resellers. *See* Kennedy A. Brooks, *VADs, VARs, and Authorized Dealers—Do the Franchise Laws Apply to the Computer Industry?*, 12 *Hastings Comm. & Ent. L.J.* 33 (1989). A computer distributor or reseller "whose business is focused on, if not completely dedicated to, the hardware of a particular manufacturer is unlikely to resist initial manufacturer demands and even less likely to resist future shifts in the manufacturer's policies or requirements." *Id.* at 35. This symbiotic relationship is described by *Neptune T.V., supra*, 190 N.J. Super. at 160, as a "hallmark of the franchise relationship."

In short, we cannot say that the trial court erred in finding that the CCC-ISI relationship showed a community of interest.

VI

If there is a New Jersey Franchise, does the Act have extraterritorial reach to the franchise activities in states other than New Jersey?

This question is closely related to the initial choice-of-law question discussed in Part III, *supra* at ___ (slip op. at 22-29). If New Jersey law, rather than California law, applies, does the application of New Jersey law stop at New Jersey's border? Recall that the Chancery Division reasoned that although the Legislature did not intend that the Act's provision apply extraterritorially, the parties had given the law that effect. The reasoning echoes that of a Florida court that ruled that a Florida Mercedes dealer could invoke New Jersey's Franchise Practices Act because the New Jersey subsidiary of Mercedes that granted the Florida dealership had expressly made the New Jersey law applicable to the contract. *Mercedes-Benz of N. Am.* v. *Department of Motor Vehicles*, 455 *So.* 2d 404 (Fla. Dist. Ct. App. 1984).

We are not so certain that the same analogy can be drawn here. Surely nothing indicates that CCC intended or agreed that the

New Jersey law would cover its activities in the sister states of New Jersey. Hence, we are remitted to the question of whether the New Jersey Legislature intended the Act to apply to franchise activities outside of the state. To return to the illustration that we gave in the choice-of-law section of this opinion, *supra* at ___ (slip op. at 27-28), would the Legislature have intended to protect a New Jersey businessperson that had invested substantial assets in a New Jersey-based hub of a multistate franchise operation?

In some measure the answer to that question depends on the extent of State power as lawmakers may have understood it. Obviously, New Jersey has no power, and therefore no interest, to regulate commerce that occurs entirely beyond its borders. *See Healy* v. *The Beer Institute, Inc.*, 491 *U.S.* 324, 109 S. Ct. 2491, 105 L. Ed. 2d 275 (1989). In *Healy*, a Connecticut statute controlling beer pricing attempted to regulate the price of liquor sold outside of the state by equating that price with the price of liquor sold in the state. The Supreme Court held that the statute violated the Commerce Clause because it had the effect of controlling commercial activity occurring wholly outside Connecticut and it facially discriminated against interstate brewers and importers, thus not advancing the state's claimed justification of insuring the lowest in-state beer prices. *Ibid.*; *see also Edgar* v. *MITE Corporation*, 475 U.S. 624, 102 S. Ct. 2629, 73 L. Ed. 2d 269 (1982) (holding that an Illinois statute regulating tender offers to shareholders beyond Illinois borders was impermissible burden on interstate commerce that outweighed its putative local benefits to in-state corporations).

The feature that distinguishes the *Edgar* decision from a case such as ours is that the Illinois Takeover Act "could be applied to regulate a tender offer which would not affect a single Illinois shareholder." *Id.* at 642, 102 S. Ct. at 2640, 73 L. Ed. 2d at 283. Thus, the Court reasoned that the Commerce Clause precluded the application of a state statute to commerce that took place wholly outside of Illinois' borders. *See also Healy, supra*, 491 U.S. at 337, 109 S. Ct. at 2500, 105 L. Ed. 2d at 289 ("Connecticut

statute has the undeniable effect of controlling commercial activity occurring wholly outside the boundary of the State").

The same analogy, however, does not apply here. To the extent that it is applicable, the New Jersey Act regulates in-state conduct that has out-of-state effects. For example, in *Mon-Shore Management, Inc.* v. *Family Media, Inc.*, 584 F. Supp. 186 (S.D.N.Y. 1984), the defendants argued that the New York Franchise Sales Act could not be applied to a franchise offer to franchisees in Pennsylvania and New Jersey. That court, however, held that to apply the New York Franchise Sales Act even though it regulated conduct in sister states was appropriate, because "an important aspect of a particular franchise transaction—an offer to sell or buy, or actual sale—occurs in the state, or *the franchise will operate in the state, or the franchisee resides here.*" *Id.* at 191 (emphasis added). The court reasoned that a state statute that affects interstate commerce will be upheld so long as it "'regulates even-handedly to effectuate a legitimate local public interest and its effects upon interstate commerce are only incidental ... unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.'" *Id.* at 190 (quoting *Pike* v. *Bruce Church*, 397 U.S. 137, 142, 90 S. Ct. 844, 847, 25 L. Ed. 2d 174, 178 (1970)). So too here, in contrast to *Edgar*, the State regulation is applicable only to specific transactions affecting New Jersey, *i.e.*, franchises that have a "place of business" in New Jersey.

Were it otherwise, nearly every aspect of substantive state law would be disabled from affecting the conduct of multi-state corporations. When New Jersey law imposes a legal duty on the volitional behavior of a contracting party, that ruling will often have effects beyond state boundaries. For example, if the issue in this case were that of straight contract law, *i.e.*, had the contract precluded termination of the out-of-state territory, the New Jersey common law upholding the contract would be regulating commerce that takes place wholly outside of the state's borders. In terms of state power, whether state contract law or state statutory law is applied to the in-state activity makes no difference. *See Ciollone* v.

Liggett Group, Inc., 505 U.S. ___, ___, 112 S. Ct. 2608, 2635, 120 L. Ed. 2d 407, 445 (1992) (Scalia, J., concurring in part, dissenting in part) (declaring that any legal duty imposed on volitional behavior is one imposed by law).

Another way of looking at the extraterritorial reach of the statute is in the context of due-process limitations on state choice of law. *See* Lea Brilmayer and Charles Norchi, *Federal Extraterritoriality and Fifth Amendment Due Process*, 105 *Harv. L. Rev.* 1217 (1992) (Brilmayer and Norchi). The leading case dealing with due-process limitations on state choice of law is *Allstate Insurance Co.* v. *Hague*, 449 U.S. 302, 101 S. Ct. 633, 66 L. Ed. 2d 521 (1981). The authors summarize the *Hague* formulation thus: "Due process [in choice of law] requires 'contacts' with the forum, 'interests' arising out of these contacts, and 'fairness' to the defendant." Brilmayer and Norchi, *supra*, 105 *Harv. L. Rev.* at 1242. That test echoes the Commerce Clause test of *Pike* v. *Bruce Church* in terms of the legitimacy of the local interest and reasonableness of the regulation.

The proposition is "fairly well established that a state may regulate its residents, even when they are acting outside of the state." *Id.* at 1241 (discussing *Skiriotes* v. *Florida*, 313 U.S. 69, 61 S. Ct. 929, 85 L. Ed. 1193 (1941)). In *Skiriotes*, the State applied its law to one of its residents who, while outside the state's territorial waters, had violated environmental regulations. The Supreme Court upheld the State's action. *Ibid.*; *Skiriotes*, *supra*, 313 U.S. at 79, 61 S. Ct. at 937, 85 L. Ed. at 1201. A State's power over its own citizens should extend to protection of its own citizens' rights when dealing with others even though there may be incidental effects in other jurisdictions.

When analyzing the constitutionality of a statute with incidental extraterritorial effect, legislative intent and constitutional power (under the Commerce and Due Process Clauses) will tend to merge. At its core, the New Jersey Franchise Practices Act is meant to deal with the unconscionable business practices affecting

New Jersey franchises. Under the *Hague* formulation we surely find "contacts" with the forum, "interests" arising out of those contacts, and "fairness to the defendant" in the statute.

Fairness to the defendant is implicit in the statute's requirements. By definition, the Act, and particularly its community-of-interest requirement, is intended to protect business parties who made a franchise-specific capital investment of either goods or services in New Jersey. *See Westfield Centre Serv., Inc. v. Cities Serv. Oil Co.*, 86 *N.J.* 453 (1981) (inequities that Legislature was trying to correct under the Act resulted from unequal bargaining power of the parties, leading to unconscionable termination provisions that imperiled innocent franchisees with substantial losses of their investments). Thus the statute's own terms, including the community-of-interest and good-cause requirements, will allow the application of the Act only in situations in which there are "contacts" with the forum, "interests" arising out of those contacts, and "fairness to the defendant" in the sense that a defendant who acts fairly with a franchisee need fear no oppressive regulation. Therefore, the Act's own terms curtail any impermissible extraterritorial effect and ensure its constitutionality under Commerce Clause or due-process analysis despite some incidental extraterritorial effects.

As noted, a critical factor in this case is the installed base of customers that ISI has built up over a twenty-year period. Because of the peculiar relationship between the hardware and the software, to terminate the franchise arrangements could be devastating within that customer base and could allow the franchisor unconscionably to reap the harvest of the franchisee's long years of effort. But a termination might not be equally devastating in all jurisdictions. The Act defines "good cause" for termination as "failure by the franchisee to substantially comply with those requirements imposed upon [it] by the franchisor." N.J.S.A. 56:10-5. To the extent that the franchisee has not met any imposed requirements to develop the franchise in the foreign jurisdiction, there may be good cause for termination. In order to resolve the

issue of "good cause" (the franchisee's failure substantially to comply with imposed requirements), the factfinder will inevitably have to weigh the interests, including the percentage of sales in those jurisdictions to be terminated and the franchisee's installed base of customers, goodwill, and other investments attributable to that jurisdiction in relation to the franchise-specific investment of goods or services in New Jersey. If the franchisee will suffer no "threat to the health" of its business, *supra* at ____ (slip op. at 49) by loss of those jurisdictions (unlike the hypothetical Montvale car dealer stripped of its customer base in New York), invocation of the Act's protection against unconscionable conduct may not be warranted.

The computer-aided instruction industry has apparently entered or is about to enter an entirely new phase in which the principal product of CCC will be the intellectual content of its software—its curriculum programs. The hardware-software relationship may become less dominant, thereby diminishing the importance of the installed base of customers. However, the trial court, as discussed in Part V C, *supra* at ___ (slip op. at 42–57), did not err in finding on this record that the CCC-ISI relationship showed a community of interest sufficient to invoke the Act's protections and require evaluation of the "good cause" asserted to justify the termination.

VII

CONCLUSION

In many ways this case illustrates the profound difficulties of encapsulating a concept of economic fairness in statutory language. This case fulfills the prophecy of the first speaker at the 1971 hearing on the Franchise Practices Act. Noting that franchising had been with us a long time and embraces *many types* of relationships and distribution techniques, involving all kinds of products and services, he ruefully predicted that "this bill delegates to the courts the power to decide, on a case-by-case basis, whether

a person has a right to use someone else's trade name or trademark as long as he so chooses." *Hearing on A. 2063, supra,* at 3-4 (testimony of Peter Dorn, Secretary of the New Jersey State Chamber of Commerce). He posed a series of hypothetical questions that he foresaw under the Act, and asked: "Must the validity of these, and many similar provisions, which are common to present day franchising agreements, be tested in courts before there can be any certainty that they will not bestow a franchise for as long as the franchisee chooses to retain it ...?" *Id.* at 4.[9] In this case, the answer to that question appears to be "yes." However, because this is the first time the Court has addressed such questions in detail, we doubt that, in general, parties are left with such uncertainty. All members of the Court agree that the issues are to be decided under New Jersey law. Concerning the application of that law to the facts, a factfinder might possibly have reached a different result in this case because the issues are indeed closely balanced. Moreover, only part of the case has been decided. Obviously, in the somewhat unusual posture of this case our courts were not called on to decide all of the issues in dispute, such as whether ISI had voluntarily surrendered its claims in certain states, *supra* at ___ (slip op. at 5), or whether CCC had imposed "unreasonable performance standards" on ISI, *ibid.*, or even whether CCC had "good cause" under the Act to terminate the franchise in the foreign jurisdictions. All that the Chancery Division adjudicated was that the relationship between the parties constituted a "franchise" and that that relationship was subject to the Act.

The startling technological changes of the recent era will perhaps occasion legislative review of the Act. "The growth of the computer industry has been fast-paced and manufacturers need flexibility and freedom from unreasonable contractual restraints in order to respond to rapidly changing markets." Brooks, *supra,* 12 *Hastings Comm. & Ent. L.J.* at 35 (footnote omitted). Yet, the author asserts "[t]hese conflicts between powerful manufacturers

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[9] We omit reference to a treble-damage provision that was deleted from the final bill.

and weaker [distributors] ... are the exact types of issues that the franchise laws were designed to regulate." *Ibid.* For now, courts must attempt to determine on a "case-by-case basis" the nature of the relationship and the just obligations of the parties to the franchise contract. Absent a compelling sense of inequity or injustice, courts do not seek to reorder the contracts of private parties. Such matters are best left to the sound economic judgment of the contracting parties. The New Jersey Franchise Practices Act is not a trap for the unwary. We are certain that contracting parties, even in a rapidly evolving industry such as the computer industry, can develop performance standards that will suitably gauge the franchisee's performance and whether it has fulfilled the expectations of the contract. No one has questioned that if product sale quotas are not met or product is disparaged, a franchise should justly be terminated. *See Amerada Hess Corp.* v. *Quinn*, 143 *N.J. Super.* 237 (Law Div. 1976) (addressing termination of a franchise relationship for failure substantially to perform).

The judgment of the Appellate Division is reversed and the judgment of the Chancery Division is reinstated.

Chief Justice Wilentz and Justices Handler and Stein and Judge King join in this opinion. Judge D'Annunzio has filed a separate dissenting opinion in which Justice Clifford joins. Justices Pollock and Garibaldi did not participate.

D'ANNUNZIO, J.A.D. (temporarily assigned), dissenting.

The New Jersey Franchise Practices Act (the Act) is very strong medicine. It provides in part that a franchise may not be terminated, cancelled, or non-renewed "without good cause." *N.J.S.A.* 56:10-5. The Act narrowly defines "good cause" as "failure by the franchisee to substantially comply with those requirements imposed upon him by the franchise." *Ibid.* Thus, if a dealer deemed to be a franchisee under the Act is fulfilling its contractual obligations, its supplier would not be permitted to make good faith structural changes in the way it markets its product or service if the changes included termination of the dealer's "franchise." *See Westfield Centre Serv.* v. *Cities Serv. Oil Co.*, 86 N.J. 453 (1981); *New Jersey American, Inc.* v. *Allied Corp.*, 875 F.2d 58 (3d Cir. 1989); *Carlos* v. *Philips Business Sys., Inc.*, 556 F. Supp. 769 (E.D. N.Y.), *aff'd*, 742 F.2d 1432 (2d Cir. 1983). Moreover, many attempts by a franchisor to terminate a franchise for good cause will result in litigation, in which a judge or jury will be permitted to review the franchisor's business decision.

In light of the Act's restrictions on a franchisor's business discretion and, therefore, on its ability to adjust to market developments and competitive pressures, and the Act's abrogation of common-law principles regarding termination and expiration of contracts, we scrupulously must avoid extending the Act's reach beyond the Legislature's intent. *See In re Miller*, 90 N.J. 210, 218-219 (1982) (declaring perpetual contractual performance is not favored in the law); *Bak-A-Lum Corp.* v. *Alcoa Building Prod. Inc.*, 69 N.J. 123, 129 (1976) (holding distributorship agreement terminable without cause on reasonable notice); *Owens* v. *Press Publishing Co.*, 20 N.J. 537, 550 (1956) (explaining that contract ceases to exist upon expiration of its term); *Karl's Sales & Serv.* v. *Gimbel Bros.*, 249 N.J. Super. 487, 495 (App. Div.) (holding that where right to terminate is absolute, it may be exercised without

regard to motive or reasons), *certif. denied*, 127 N.J. 548 (1991); *cf. Oswin* v. *Shaw*, 129 N.J. 290, ___ (1992) (slip op. at 25-26) (stating that doubt about meaning of statute in derogation of common law "should be resolved in favor of 'the effect which makes the least rather than the most change in the common law'" (quoting 3 Norman J. Singer, *Sutherland Statutory Construction* § 61.01, at 77 (4th ed. 1986))).

There is no doubt that the Legislature did not intend to reach all supplier-dealer relationships, despite the Legislature's use of language broad enough to include all such relationships. The parties and the majority concede as much. The use of broad language and the universal acceptance of the premise that the Act's reach is more limited than the literal application of that language place on the courts the burden of establishing the Act's limits in more concrete terms, consistent, of course, with the legislative intent. We must do this to decide the present case and to provide the business community with the objective standards it requires for predictability and guidance.

Although our task is to determine what the Legislature intended when it defined the word *franchise*, its use of that word is significant. *Cf. Gabin* v. *Skyline Cabana Club*, 54 N.J. 550, 554 (1969) (explaining that title of statute may indicate a legislative intent to apply narrowly the broad language of the enactment); *Samuel D. Wasserman, Inc.* v. *Klahre*, 24 N.J. Super. 143, 147 (App. Div. 1952) (declaring that statute's title is relevant to its construction); *accord Casey* v. *Male*, 72 N.J. Super. 288, 297 (Law Div. 1962).[1] There is a common understanding of what the word franchise evokes: fast food (McDonald's; Pizza Hut), ice

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[1] The Act is titled: "An Act to prohibit unfair practices in franchising and supplementing Title 56 of the Revised Statutes." Compare, for example, the Wisconsin statute, which is titled the Wisconsin Fair Dealership Law. *Wis. Stat. Ann.* § 135.01 to 135.07 (1991). As its title implies, it is broader than the Act. It applies to contracts "by which a person is granted the right to sell or distribute goods or services." *Wis. Stat. Ann.* § 135.02(3).

cream (Carvel; Dairy Queen), hotels (Holiday Inn; Hilton), and automobile service facilities (AAMCO; Midas Muffler) are well known examples of business format franchises. See United States Department of Commerce, *Franchise Opportunities Handbook* (1991)(hereinafter *Opportunities)* and Bryce Webster, *The Insider's Guide to Franchising* (1986) (for comprehensive lists of businesses offering franchises in the United States). Gasoline stations (Exxon; AMOCO), automobile dealerships (General Motors; Ford), tools (Mac Tools) and water conditioning (Culligan International) are examples of product franchising. *See Shell Oil Co.* v. *Marinello*, 63 N.J. 402, 409 (1973), *cert. denied*, 415 U.S. 920, 94 S. Ct. 1421, 39 L. Ed. 2d 475 (1974); *Tynan* v. *General Motors Corp.*, 248 N.J. Super. 654 (App. Div. 1991), *certif. denied*, 127 N.J. 548 (1991), *rev'd in part on dissent*, 127 N.J. 269 (1992); *Opportunities*, *supra*, at 268–69. Manufacturing franchises are less well known, but the soft drink industry relies heavily on the franchising of beverage production. *Webster*, *supra*, at 6–7. I agree with the majority that those are the prototypes the Legislature envisioned when it adopted the Act. Indeed, the legislative history indicates that the New Jersey Gasoline Retailers Association and the New Jersey Automobile Dealers Association were principal supporters of the Act. Franchise Practices Act: *Hearing on A.2063*, Assembly Judiciary *Comm.*, 194th Leg., Sess. (1971)

The prototypes inform us of the legislative intent. The prototypes have two primary characteristics: the product or service is marketed primarily through brand-name recognition; the franchisee adopts the franchisor's trade name as its own name, presenting itself substantially as a unit of the franchisor. *See Colt Indus. Inc.* v. *Fidelco Pump & Compressor Corp.*, 844 F.2d 117, 119 (3d Cir. 1988); *Susser* v. *Carvel Corporation*, 206 F. Supp. 636 (S.D.N.Y. 1962), *aff'd*, 332 F.2d 505 (2d Cir. 1964), *cert. dismissed*, 381 U.S. 125, 85 S.Ct. 1364 14 L. Ed. 2d 284 (1965); *Finlay & Assocs.* v. *Borg-Warner*, 146 N.J. Super. 210, 219 (Law Div. 1976), *aff'd o.b. on other grounds*, 155 N.J. Super. 331 (App. Div.), *certif. denied*, 77 N.J. 467 (1978); *see also Webster*, *supra*, at 4–5; Donald D. and Patrick J. Boroian, *The Franchise*

Advantage (1987) 16–17; Harold Brown, *Franchising: Trap for the Trusting* 89 (1969). *But cf. Neptune T.V. & Appliance Serv., Inc.* v. *Litton Sys., Inc.*, 190 N.J. Super. 153, 160 (App. Div. 1983) (defining "franchise" in terms of a public perception that licensor vouches for licensee).

The trial court in *Susser* v. *Carvel Corporation*, *supra*, 206 F. Supp. at 640–41, aptly described some of the characteristics of a franchise:

> The plaintiffs' franchise agreements require the franchisees to operate their stores in accordance with a Standard Operating Procedure Manual (SOP). This SOP regulates the business of the operators in a number of respects. It describes the products which the operators may sell at their store, the advertising which they may use, the color they must paint their store, the hours when they must put on their lights, the amount of insurance they must carry, the colors of their employees' uniforms, and many other details. To the public the individual franchise operator appears to be part of a national organization which manufactures and distributes a limited type of products of uniform quality. The Carvel SOP refers to each store as "an integral part of the chain."
>
> * * * *
>
> ... The franchise system creates a class of independent businessmen; it provides the public with an opportunity to get a uniform product at numerous points of sale from small independent contractors, rather than from employees of a vast chain. The franchise system of operation is therefore good for the economy.

> However, the cornerstone of a franchise system must be the trademark or trade name of a product. It is this uniformity of product and control of its quality and distribution which causes the public to turn to franchise stores for the product....
>
> It is this uniformity of stores and operation, and this advertising and the knowledge of the public of the uniformity and quality of the product that draws the business to the Carvel operators. The name Carvel constitutes a trademark of great value to the defendant companies and to the franchise operators.

The actual, or perceived, acceptance of a brand name in a national or regional market as representing a useful and quality product or service is what makes the franchise valuable to the potential franchisee. Through a franchise, the franchisee believes that it will reap the benefits of brand recognition that otherwise would be attainable, if at all, only through substantial effort and expense. It is this perceived value that gives a franchisor the upper hand and the ability to dictate the terms of its franchise. And it was that inequality of bargaining power and the resulting onerous terms frequently imposed on franchisees that moved many state legislatures to consider and enact statutes, similar to New Jersey's Act, purporting to protect franchisees. *See* Brown, *supra.*

The major benefit of a franchise—the franchisee's use, as its own, of the franchisor's trademark and trade name—becomes a major disadvantage if the franchise is terminated. On termination of a franchise, the franchisee cannot convert to its own benefit the goodwill it has helped to sustain by years of work. *See Shell Oil Co.* v. *Marinello, supra,* 63 N.J. at 409. Even if the terminated franchisee retains ownership of the physical plant and equipment, it cannot effectively capitalize on its years of effort by restyling its former nationally-recognized hamburger fast-food outlet as "Joe's Hamburger Palace," or, in the case of a manufacturing franchise,

by producing a soft drink whose newly-created trademark and name are unknown to soft drink consumers.

The context in which the Legislature adopted the Act, *see Board of Educ., Asbury Park* v. *Hoek*, 38 N.J. 213, 231 (1962), and the "background circumstances revealing the evil sought to be remedied," *Oxford Consumer Discount Co.* v. *Stefanelli*, 102 N.J. Super. 549, 565 (App. Div. 1968), persuade me that the first element of the definition of franchise, "a written arrangement ... in which a person grants to another person a license to use a trade name, trademark, service mark, or related characteristics," N.J.S.A. 56:10–3, refers to a license to use the trade name, etc. substantially as the licensee's own in circumstances in which the licensee presents itself as a unit, or the *alter ego*, of the licensor. *Cf. Roman* v. *Sharper*, 53 N.J. 338, 342 (1969) (holding that legislative intent effected "by adding inferentially" the phrase "qualified to vote" to the language of a statute authorizing recall elections). This formulation of the franchise definition, the prototype definition, objectively distinguishes a franchise from other supplier–dealership arrangements, thereby giving effect to the legislative intent and providing guidance and a greater degree of predictability to the business community. *Cf. Council of N.J. State College Locals* v. *State Bd. of Higher Educ.*, 91 N.J. 18, 36 (1982) ("Statutes should be read in a reasonable manner to include only those situations legitimately contemplated by the Legislature.").

The prototype definition avoids the subjective and vague definition developed in *Neptune T.V. & Appliance Service, Inc.* v. *Litton Systems, Inc.*, *supra*, 190 N.J. Super. at 160:

> The use of another's trade name in such a manner as to create a reasonable belief on the part of the consuming public that there is a connection between the trade name licensor and licensee by which the licensor vouches, as it were, for the activity of the licensee in respect of the subject of the trade name.

The *Neptune* definition is seriously flawed because it relies on the public's belief. In addition to the difficulty of proving what the public believes, the *Neptune* definition ignores the statute's reliance on the grant of authority from the licensor to the licensee. N.J.S.A. 56:10–3a. Under the Act's definition of a franchise it is the agreement between the parties that is controlling, not the public's possibly erroneous, and perhaps undeterminable, belief. Moreover, the *Neptune* definition introduces the new and imprecise element of vouching for the licensee's activity. That element suffers from the same infirmity as a literal application of the Act's definition: it probably exists in all licensor-licensee relationships.

The majority is incorrect when it suggests that N.J.S.A. 56:10–4(3) precludes the prototype definition. That section provides that the Act applies "only to a franchise ... (3) where more than 20% of the franchisee's gross sales are intended to be or are derived from such franchise." According to the majority, "the inclusion of independently-named businesses is implicit in the Act's definition of franchise by the Act's limitation to a franchise" which generates more than 20% of the franchisee's gross sales. *Ante* at ___ (slip op. at ___). The majority misunderstands the applicability of the 20% limitation. It is applicable to a franchisor who sells products complementary to the franchised product or who has multiple franchises. The operator of a neighborhood gasoline station franchised to sell a national brand of petroleum products may generate more than 80% of its gross sales from tires, batteries, accessories, and mechanical work, see *e.g.*, the facts in *Muha* v. *United Oil Co., Inc.*, 433 A.2d 1009 (Conn. 1980), or may also be franchised to sell Goodyear tires, or to rent automobiles under a Hertz franchise. In those circumstances the franchisee does not do business in its own name; rather, it adopts the names of its franchisors and presents itself as units of each of the franchisor companies. If one (or more) of the franchises does not generate

more than 20% of the franchisee's gross sales, then the Act is not applicable to that franchise.[2/]

The relationship between CCC and ISI is not a franchise under the Act. The majority concedes "[t]hat ISI does not use CCC's name as its own .... ISI has always operated under its own trade name, and admits that it does not use CCC's name on its stationery, business cards, or on any business signs." *Ante* at ___ (slip op. at 38). Of great significance, not mentioned by the majority, is the fact that once ISI makes a sale, the contract of sale is between ISI and the customer.

The agreement between ISI and CCC gives ISI a limited right to the use of CCC's trade name and trademark. Section 6.02 of the Agreement obligates ISI to "promote CCC's name, trademark and logo *on the Products.*" (Emphasis added.) It also authorizes ISI, "subject to the provisions of Part 11 hereof, to use CCC's name, trademark and logo in its advertising, exhibits, trade shows, public relations materials and manuals *as the same relates to the Products.*" (Emphasis added.)

Section 6.03 establishes the boundaries of ISI's authority. It provides that ISI "shall not enjoy any rights in the CCC name, its trademark or logo" except as permitted under section 6.02. Part 11 more specifically restricts ISI's use of CCC's trademark. Pursuant to section 11.01, "ISI agrees that it shall only use, make reference to, or otherwise designate, either orally or in writing, CCC's trademarks or its licensors' trademarks, in the promotion or Sale of the Product." Section 11.02 imposes additional restrictions. It provides, in part, that when ISI uses CCC's trademark in connection with CCC's products, "ISI shall clearly indicate CCC's owner-

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[2/] Multi-point automobile dealerships provide another example of multiple franchises. A dealer holding a franchise from a domestic manufacturer may also have a franchise to sell an import. If the import's sales do not exceed 20% of the dealer's total sales, then the Act is not applicable to that franchise. Other examples of the applicability of the 20% minimum to prototype franchise situations abound.

ship of the trademark 'CCC'," and that "ISI shall not in any matter represent that it has ownership in the trademark 'CCC'." Finally, section 11.02 provides that "ISI will at no time adopt for use, without CCC's prior written consent, any word or mark which is similar to or likely to be confused with the trademark of 'CCC'."

The parties' agreement severely limits ISI's use of CCC's mark and name to the identification of the products it is selling as CCC products. The agreement does not authorize ISI to use CCC's name or mark as its own or to present itself as a CCC unit. Thus, not only does ISI not present itself as CCC, it is prohibited from adopting or using CCC's mark or name as its own. Consequently, the first element of the definition of "franchise" has not been established. ISI is a dealer authorized to sell and service CCC's products; it is not a franchisee.

I would affirm the judgment of the Appellate Division.

Justice Clifford joins in this dissent.

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

9 November 1993

NOT FOR PUBLICATION

LETTER-OPINION
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Re: *Instructional Systems, Inc.* v. *Computer Curriculum Corp.*
Civil Action No. 89-502 (AJL)

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Introduction

Currently before the court is a motion of defendant Computer Curriculum Corp. ("CCC") for partial summary judgment pursuant to Fed. R. Civ. P. 56.[1] The motion is addressed to that portion

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[1] In support of its motion for partial summary judgment, CCC submitted the following: Memorandum of Law in Support of Defendant Computer Curriculum Corporation's Motion for Summary Judgment on the Remaining Counts of the Complaint (the "CCC Moving Brief"); Statement of Material Facts Not in Dispute (the "CCC 12G Statement") (attached as Appendix to the Moving Brief); Affidavit of William Slater, dated 25 June 1993 (the "Slater Aff."); Affidavit of Sidney Rosdeitcher, dated 25 June 1993 (the "Rosdeitcher Aff."); Certification of Ronald F. Fortune, dated 30 August 1993 (the "Fortune Certif."); Certification of Jay Greenfield, dated 27 August 1993 (the "Greenfield Certif."); Reply Memorandum of Defendant Computer Curriculum Corporation in Support of Its Motion for Summary Judgment on the Remaining Claims of the Complaint (the "Reply Brief").

In opposition to the motion for partial summary judgment, plaintiff Instructional Systems, Inc. ("ISI") submitted the following: Plaintiff's Brief in Opposition to Defendant's Motion for Summary Judgment (the "ISI Opposition Brief"); General Rule 12G Statement (the "ISI 12G Statement"); Certification of Douglas S. Eakeley, dated 18 August 1993 (the "Eakeley Certif.").

Oral argument was heard on 12 October 1993. At oral argument, the parties were asked to submit additional briefing to identify exactly what issues were remanded to the state courts in 1989 and what issues were resolved by the state courts. *See* Transcript of Proceedings, 12 October 1993, at 2-3. In connection with that request, CCC submitted the following: Supplemental Memorandum of Defendant Computer Curriculum Corporation in Support of its Motion for Summary Judgment on the Remaining Claims of the Complaint (the "CCC Supplemental Brief"); Supplemental Reply Memorandum of Defendant Computer Curriculum Corporation in Support of its Motion for Summary Judgment on the Remaining Claims of the Complaint (the "CCC Supplemental Reply Brief"). ISI submitted the following: Plaintiff's Supplemental Submission in Opposition to Defendant's Motion for Summary Judgment (the "ISI Supplemental Brief"); Appendix to Plaintiff's Supplemental Submission in

(continued...)

of count one of the complaint, filed 30 January 1989 (the "Complaint") by ISI, which was not dismissed on partial summary judgment in *Instructional Systems, Inc.* v. *Computer Curriculum Corp.*, 826 F. Supp. 831 (D.N.J. 1993) ("*Instructional Systems II*"), as well as counts two through seven of the Complaint, is granted.

For the reasons set forth below, the aspect of the CCC motion for summary judgment addressed to the portion of count one of the Complaint which alleges a violation of N.J.S.A. § 56:10-7(e) is denied; the aspect of the CCC's motion for summary judgment addressed to that portion of count one of the Complaint which alleges a violation of N.J.S.A. § 56:10-5 and is addressed to counts two through seven of the Complaint is granted.

[1/](...continued)
Opposition to Defendant's Motion for Summary Judgment (the "ISI Supplemental Appendix"); Plaintiff's Reply Supplemental Submission in Opposition to Defendant's Motion for Summary Judgment (the "ISI Supplemental Reply Brief").

In response to court's request for additional documents made in a letter, dated 21 October 1993, CCC submitted the following documents: Documents Requested in Letter of Judge Lechner Dated 21 October 1993, attaching Exhibits 4 to 36 (the "CCC Exhibits"); Appendix - Volume I, submitted to the New Jersey Appellate Division (the "CCC Appendix Vol. I"); Appendix - Volume II, submitted to the New Jersey Appellate Division (the "CCC Appendix Vol. II"); Appendix - Volume III, submitted to the New Jersey Appellate Division (the "CCC Appendix Vol. III"); Appendix - Volume IV, submitted to the New Jersey Appellate Division (the "CCC Appendix Vol. IV"); Transcripts of Proceedings, submitted to the New Jersey Appellate Division. ISI submitted the following: Volume I to the Rochford Certification (the "ISI Vol. I"); Volume II to the Rochford Certification (the "ISI Vol. II"); Volume III to the Rochford Certification (the "ISI Vol. III"); Volume IV to the Rochford Certification (the "ISI Vol. IV"); Volume V to the Rochford Certification (the "ISI Vol. V").

Facts

A. The Parties and Their Relationship

1. The Parties

CCC is a Delaware corporation with its principal place of business in Palo Alto, California. Complaint, ¶ 4; Defendant Computer Curriculum Corporation's Answer to Complaint, Affirmative Defenses and Counterclaims, filed 27 March 1989, ¶ 2. Since the mid-1970s, CCC has developed and produced computer software, hardware and other products known as integrated learning systems (the "Integrated Learning Systems").[2/] Suppes Decl., ¶ 2. CCC sells the Integrated Learning Systems to

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[2/] ISI describes the Integrated Learning Systems as follows:

> The heart of the system is a series of computer software programs, described as "courseware," stored in a powerful host computer called the "MICROHOST," and student learning stations which are themselves micro-computers, equipped with display screens and keyboards. The student interacts with the courseware through the keyboard and screen. This system is capable of providing as many as 128 students simultaneously, at as many as 128 separate remote locations, with access to approximately 30 multi-year courses, many of which span the entire curriculum from Kindergarten through eighth grade, and in some cases beyond.

Certification of Phyllis Kaminer ("Kaminer"), dated 13 June 1989 (the "Kaminer Certif."), attached as Exhibit A to Eakeley Certif., ¶ 33; *see* Memorandum of Law in Support of Defendant Computer Curriculum Corporation's Motion for Partial Summary Judgment Based on the Commerce Clause, dated 11 January 1993 (the "Commerce Clause Moving Brief"), at 3-4; Declaration of Patrick Suppes ("Suppes") in Opposition to Plaintiff's Application for a Preliminary Injunction and Motion for Partial Summary Judgment and in support of Defendant's Motion for Partial Summary Judgment (the "Suppes Decl."), filed 27 June 1989, ¶ 2.

purchasers located throughout the United States. *Id.* School districts are the primary purchasers of Integrated Learning Systems. *Id.*

CCC was founded by Suppes who is "a recognized authority in the field of education" and is "widely regarded as a preeminent leader in the development of computer assisted instruction." Kaminer Certif., ¶¶ 36-37. Suppes was also the president and chief executive officer of CCC and owned approximately eighty percent of the stock of CCC. *Id.*, ¶ 36.

ISI is a New Jersey corporation with its place of business in Hackensack, New Jersey. Complaint, ¶¶ 1-2; Kaminer Certif., ¶ 9. ISI was formed by Kaminer[3] under the name Educomp of New Jersey.[4] Kaminer Certif., ¶ 4. The name was later changed

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[3] Kaminer has a Bachelor of Arts degree in mathematics from Brooklyn College and a Masters of Arts degree in mathematics from City College of New York. Kaminer Certif., ¶ 2. She also has an Masters in Business Administration from Columbia University. *Id.* She worked as a computer programmer in the physics department at the Brookhaven National Laboratories and as a programmer and programming supervisor at Columbia University in the Electrical Engineering Department. *Id.* Kaminer then joined G.C. Dewey Co. where she worked on computer applications for military and government contracts. *Id.* She subsequently joined ITT as a supervisor in charge of programming for various contracts and developing new proposals for future computer projects. *Id.* Kaminer then served as the assistant director for an office involved with computer matters for the Secretary of the United States Department of Health Education and Welfare. *Id.* Subsequently, she worked for Educational Data Services, a company involved in computers and education. *Id.* In 1972, she became involved with Educomp of Connecticut. *Id.*

[4] Educomp of New Jersey was incorporated in 1971 or 1972. Excerpts of the Kaminer Deposition on 2 May and 11 May 1989, attached as Exhibit C to the Rosdeitcher Aff. (the "Kaminer Dep. Tr."), at 20. At that time, Kaminer held one hundred percent of its stock. *Id.*

to ISI. *Id.*, ¶ 5. ISI has maintained its offices in New Jersey; its sales force and consultants work out of New Jersey. *Id.*, ¶ 13.

2. The Initial Meeting

Kaminer learned of CCC in the mid-1970s while she was working with Educomp of Connecticut.[9] Kaminer Certif., ¶ 3. Educomp of Connecticut was a company involved in computers and education. *Id.* Kaminer was assisting Educomp of Connecticut in expanding its marketing efforts into the Mid-Atlantic states. *Id.* Kaminer's first big sale of Educomp products was to the Englewood, New Jersey school system. In the process of that sale, Kaminer discovered the Englewood school system was also interested in certain CCC mathematics courseware. *Id.* Kaminer investigated CCC for the Englewood school system and, in connection with that investigation, visited CCC's facilities in California. *Id.* At the time of Kaminer's visit, CCC had approximately six employees. *Id.*

Although the Englewood school system ultimately decided against purchasing the CCC courseware, Kaminer's interest in CCC continued. *Id.*, ¶ 4. In approximately 1975, Kaminer approached CCC with a proposed arrangement whereby Kaminer would market CCC products in the northeastern United States. *Id.*

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[9] Kaminer's company, Educomp of New Jersey, had an agreement with Educomp of Connecticut for use of the name "Educomp." Kaminer Dep. Tr. at 21-22. Educomp of Connecticut developed new computer programs and assembled publicly available software. *Id.* at 23-24. Educomp of New Jersey then packaged that software in a way schools would find convenient. *Id.* at 24. Educomp of New Jersey sold the software to schools in New York, New Jersey, Maryland and Delaware. *Id.* Educomp of Connecticut concentrated its sales efforts on the New England area. *Id.* Both Educomp of New Jersey and Educomp of Connecticut resold hardware to schools in their respective areas, which hardware they purchased from Digital Equipment Corporation. *Id.* at 24-25.

The products were to be marketed through Kaminer's corporation, ISI (at that time known as Educomp of New Jersey). *Id.* CCC, which in 1974 had decided to expand its marketing efforts into the northeastern United States, agreed to the arrangement. *Id.*, ¶¶ 6, 39. Kaminer hired two employees to assist her in marketing CCC products. *Id.*, ¶ 6. By 1980, CCC and ISI agreed ISI would have an exclusive distributorship in the marketing territory consisting of Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island, Vermont and Washington, D.C. (the "Marketing Territory"). *Id.*, ¶¶ 7, 41; ISI 12G Statement, ¶ 2; CCC 12G Statement, ¶ 1.

3. The Relationship

ISI began its operations as an exclusive distributor of CCC products in Englewood Cliffs, New Jersey (the "Englewood Facility"). Kaminer Certif., ¶ 9. ISI remained at that location until 1986. *Id.*, ¶ 11. The Englewood Facility included a time sharing center for the sale of Microhost computers.[9] *Id.*, ¶ 10. The Englewood Facility also included computers for display and demonstrations and a conference room/auditorium in which ISI conducted customer demonstrations of hardware, software and courseware as well as marketing meetings and training activities. *Id.*

In 1986, ISI moved its marketing facility to Hackensack, New Jersey (the "Hackensack Facility"). *Id.*, ¶ 11. The Hackensack Facility appears to be a larger version of the Englewood Facility. *See id.*

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[9] As stated, *supra* n.2, Microhost computers were used to run CCC software and courseware. The Englewood Facility's time sharing center also provided facilities for the sale of the CCC-17 computer, predecessor to the Microhost computer. Kaminer Certif., ¶ 10.

As a re-seller of CCC products, ISI purchased and licensed those products from CCC and, in turn, sold and sublicensed those products to end-users in the Marketing Territory. ISI also provided a system of training and support for its customers including orientation programs in the use of the CCC system. *Id.*, ¶ 44 & n.2.

ISI contends CCC products "are a unique combination of hardware and software whose identity is integrally related to that of ISI."[2/] ISI 12G Statement, ¶ 4. From 1985 through 1989, sales of CCC products constituted ninety-seven percent of ISI's total sales revenues. ISI 12G Statement, ¶ 5; Kaminer Certif., ¶ 80. ISI, meanwhile, became the largest single customer of CCC, with CCC sales to ISI constituting between twenty-one to thirty percent of CCC's gross revenues. Kaminer Certif., ¶ 57.

In promoting and selling CCC products, ISI contends it made "significant franchise specific investments." ISI 12G Statement, ¶ 8. For example, ISI asserts it outfitted the Hackensack Facility with specialized CCC equipment so that it could demonstrate CCC products for prospective customers and train existing customers in a simulated classroom setting. Kaminer Certif., ¶¶ 18-20. ISI asserts other CCC-specific arrangements included the purchase and distribution of flyers, brochures and marketing letters bearing the CCC name, logo and trademark and the display of the CCC name, logo and trademark at the Hackensack Facility. *Id.*, ¶¶ 16, 19, 21, 23.

ISI claims to have spent millions of dollars on its sales and promotional activities for CCC products. This expenditure included

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[2/] ISI further contends there is no alternative line of products ISI can substitute and sell in place of CCC products. ISI 12G Statement, ¶ 5; Kaminer Supplemental Certif., ¶ 12.

special presentations, seminars and cable television programs on educational issues, sponsoring customer visits to the CCC headquarters in California, developing proprietary software sold by ISI at a loss to itself in order to attract potential customers, hiring consultants and conducting studies on educational issues and computer assisted instruction. *Id.*, ¶¶ 45-46, 61-63.

Despite the fact both ISI and CCC began their relationship as two small, private companies, owned by sophisticated persons knowledgeable about the computer industry, ISI maintains it "has always been at the mercy of CCC," and CCC "has exerted significant control over the manner in which ISI conducts its business." Kaminer Supplemental Certif., ¶ 32; Complaint, ¶ 15. ISI explains the "myriad of ways" in which CCC exercised that control as follows:

> CCC controls ISI from the way we do our inspections, from the way that we train our staff. In fact, they [CCC] train us. From the way that everything that I [Kaminer] want to do I have to ask their permission for, special this, special that.... From the way that every document that we sent in with respect to site inspections and layouts we would get criticisms and critiques on. CCC would dominate and has dominated almost every aspect of what we do.

Kaminer Dep. Tr. at 47. ISI contends it has been CCC's "clear intention to make ISI almost entirely dependent on CCC." Kaminer Certif., ¶ 49; *see id.*, ¶¶ 51(a)-(i), 52. ISI explains that the ability of CCC to control it arises from the exclusivity of the CCC

product line and the role of ISI as the exclusive distributor of those products.[1] Kaminer Supplemental Certif., ¶ 32.

4. The ISI Understanding of the Relationship with CCC

From the outset of their relationship, ISI and CCC entered into a series of written contracts, each for a definite term. Kaminer Certif., ¶ 42. ISI states that upon termination of one agreement, a renewal contract was usually presented to Kaminer by Suppes as a "*fait accompli*." *Id.*, ¶ 43. It is contended no material discussion or negotiation surrounded these renewal contracts. *Id.*

CCC asserts ISI, early in the relationship, proposed it be given a "perpetual distributorship." Commerce Clause Moving Brief at 5; *see* Affidavit of Ronald F. Fortune, submitted in support of CCC's motion for partial summary judgment on the Commerce Clause issue, dated 8 January 1993 (the "Fortune Aff."), ¶ 12; Suppes Decl., ¶ 5; Kaminer Dep. Tr. at 42. CCC rejected the proposal. Commerce Clause Moving Brief at 5; *see* Fortune Aff., ¶ 12; Suppes Decl., ¶ 5. According to CCC, a series of temporally finite contracts was preferable because "[t]he computer industry is very dynamic."[2] Commerce Clause Moving

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[1] Despite what ISI describes as the overwhelming control of it by CCC, sometime in 1985, ISI managed to "scrape together" funds to attempt to buy CCC. *See* Kaminer Supplemental Certif., ¶ 32; Suppes Decl., ¶ 9. ISI states it was concerned about its future upon learning in 1985 that Suppes was considering selling CCC. Kaminer Supplemental Certif., ¶ 32. Suppes did not sell CCC at that time.

[2] In fact, CCC states that the Integrated Learning Systems industry "ha[s] undergone a dramatic transformation" in recent years. Commerce Clause Moving Brief at 5; *see also* Fortune Aff., ¶ 2. CCC states:

(continued...)

Brief at 5; *see also* Fortune Aff., ¶ 12. ISI agreed with the need for sequential contracts with limited terms because it recognized "that conditions in the market, as well as technological changes, might require fine-tuning of the contract's provisions."[10] ISI Opposition Brief at 5; *see* Kaminer Certif., ¶ 24; Kaminer Dep. Tr. at 41-42.

ISI contends, however, that the decision to structure the arrangement between CCC and itself through a series of sequential contracts did not effect its understanding that the relationship between itself and CCC would be ongoing. ISI Opposition Brief at 5; Kaminer Certif., ¶ 40. ISI's understanding it would continue

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[9](...continued)

> What was [in the 1970s] a relatively obscure group of small start-up firms is now a rapidly growing, highly competitive $300 million business that has attracted the attention of Fortune 500 companies. Jostens, a publicly held company that has entered the I[ntegrated] L[earning] S[ystems] business in 1986, has surpassed CCC in terms of sales revenues and last year acquired the third-largest I[ntegrated] L[earning] S[ystems] firm. Several other competitors, including IBM, have also emerged. CCC itself was acquired in 1990 by Simon & Schuster, Inc. The business also has expanded into segments, such as job training for business, industry and correctional institutions. It is predicted that by 1996, sales of Integrated Learning Systems will reach $750 million annually.
>
> Commerce Clause Moving Brief at 5 n.4 (citations omitted); *see also* Fortune Aff., 2-15 (discussing increase in sales and change in market of Integrated Learning Systems). It is predicted that by 1996, sales of Integrated Learning Systems will reach $750 million annually. Fortune Aff., ¶ 3. ISI agrees competition in the Integrated Learning systems business has "become much more intense." Kaminer Certif., ¶ 60.

[10] In fact, some provisions did change from one contract to the next. Changes typically related to operational matters such as discounts and copyright protection. Kaminer Certif., ¶ 42.

indefinitely as the sole distributor of CCC products was allegedly established at the beginning of CCC's and ISI's relationship. ISI Opposition Brief at 5; Kaminer Certif., ¶ 40.

ISI claims that when CCC offered it the exclusive distributorship in 1975, Suppes "told [Kaminer] that ISI would continue to be CCC's sole and exclusive distributor as long as ISI was able to meet reasonable marketing quotas."[11] ISI opposition Brief at 5; Kaminer Certif., ¶ 40. As evidence of this understanding, ISI points to the following two incidents:

> [Suppes] once sent me [Kaminer] a letter ... it was in the early years, certainly ten years ago, in which he had been talking about setting guidelines or targets or quotas, I'm sorry I don't have the exact wording, but it's something to the degree that there is no point in setting goals if the relationship is not continued if those goals are met.[12] Then I remember a time that we had lunch together in New

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[11] This contention, however, belies the wording of the agreement, signed on 12 March 1975 (the "1975 Agreement"), which included a provision whereby the 1975 Agreement automatically expired on 30 June 1977. *See* 1975 Agreement, attached as Exhibit A to the Suppes Decl., ¶ XXXI. The 1975 Agreement contained a provision which made clear that the written agreement constituted the complete agreement of the parties. *Id.*

[12] The letter Kaminer referred to stated in pertinent part:

> Upon reflection, putting in the milestones on the north and south territories at the end of three years did not make much sense unless the contract were to continue after those dates. We are therefore writing a five-year contract with no conditions on the core territory as we discussed when you were here.

Letter from CCC to ISI, dated 27 June 1977 (the "27 June 1977 Letter"), attached as Exhibit E to the Rosdeitcher Aff.

> York.... I think it was in 1976, ... and in our conversation he said, as I was describing a project [ISI] had in Delaware, ... he made a remark that always struck me and I remembered it very well in which he said he was very pleased with the work [ISI was] doing and, ... he said a lot of things but the one of the remarks that I remember him saying was, as far as I'm concerned, you're queen of the east coast. That doesn't sound like a temporary—didn't sound to me like a temporary situation. We never, that I can remember, I can never remember any time we discussed termination.

Kaminer Dep. Tr. at 29-31; *see* Kaminer Certif., ¶ 40; *see also* Excerpts from ISI's Responses to CCC's First Set of Interrogatories, dated May 10, 1989, attached as Exhibit B to the Rosdeitcher Aff., at 9.

5. The 1975 Agreement

When ISI, at that time Educomp of New Jersey, and CCC signed the 1975 Agreement, their first agreement, ISI obtained an exclusive distributorship of CCC products in Connecticut, New Jersey, New York and eastern Pennsylvania (the "1975 Marketing Territory"). 1975 Agreement, ¶ I(A).

The 1975 Agreement also gave ISI a discount of twenty-five percent on CCC products. *Id.*, ¶ III(A). The discount rate was to be adjusted based on the annual volume of discountable items purchased by ISI. *Id.*, ¶ III(A) and (B). The 1975 Agreement required ISI to use its "best efforts" to sell CCC products within the 1975 Marketing Territory and prohibited ISI from selling any competitive products. *Id.*, ¶¶ XVII, IV(C).

The 1975 Agreement stated that it was the parties' entire understanding and that it could be amended only by written

agreement. *Id.*, ¶ XXXI. By its terms, the 1975 Agreement expired on 30 June 1977. *Id.*, ¶ XVIII.

6. The 1978 Agreement

On 1 May 1978,[12] ISI and CCC signed the 1978 Agreement. *See* 1978 Agreement. The 1978 Agreement gave ISI the exclusive right to purchase CCC products and resell them in the states of Delaware, New Jersey and New York (the "1978 Marketing Territory").[13] *Id.*, ¶ 1.1

The 1978 Agreement called for ISI to use its "best efforts" to promote CCC products, to take all necessary action to create and maintain a supply of CCC products in the 1978 Marketing Territory and to supplement those efforts with whatever steps CCC reasonably requested. *Id.*, ¶ 3.1. In addition, ISI's duties included

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[12] It appears that a period of approximately nine months elapsed between the time the 1975 Agreement expired on 30 June 1977, and the execution of the agreement on 1 May 1978 (the "1978 Agreement"). It is not clear whether the terms of the 1975 Agreement were extended until the execution of the 1978 Agreement or whether the parties entered into some other arrangement.

> The 27 June 1977 Letter stated in part:
>
> We [CCC] have discussed with our attorney the new contract between ISI and CCC. He feels that there are a lot of gaps in the contract that should be covered. I don't think that what we are adding will affect the substantive discussions we had ..., but it is going to take some time to draw up the new document. I shall be out of town from July 1 to July 7; we hope to have the new contract mailed to you shortly after my return.

27 June 1977 Letter.

[13] There is no discussion or explanation given for eliminating Eastern Pennsylvania from the 1978 Marketing Territory.

locating prospective customers and marketing opportunities, training and educating customers in the use of CCC products, demonstrating CCC products to potential customers and attending trade shows and conventions to promote CCC products. *Id.*, ¶ 3.2. ISI was also required to maintain no less than two full-time, fully trained marketing representatives to work exclusively within the 1978 Marketing Territory promoting CCC products and at least one employee to train proctors and teachers in the use of CCC products. *Id.*, ¶ 3.4.

The 1978 Agreement provided ISI a discount on the prices of CCC products ranging from twenty to thirty percent based on ISI's annual volume of discountable items purchased by ISI from CCC. *Id.*, ¶ 2.1 and Schedule C.

The 1978 Agreement was terminable by either party upon thirty days' notice after 1 July 1980. *Id.*, ¶ 9.4. There was no other termination or expiration provision.

> This Agreement may be terminated by either party upon giving thirty (30) days' written notice to the other party; provided, however, that neither party shall have the right to give such thirty days' notice of termination prior to July 1, 1980.... [N]either party shall incur any form of civil liability whatsoever on the basis of any termination that is effected pursuant to the terms of this paragraph....

Id. In addition, there was a merger clause which stated the 1978 Agreement "constitute[d] the entire agreement between the parties" and "supersede[d] and terminate[d] any and all prior agreements or contracts, whether oral or in writing." *Id.*, Article XIX.

7. The 1980 Agreement

ISI and CCC entered into the third written agreement On 9 October 1980 (the "1980 Agreement"). *See* 1980 Agreement, attached in CCC Appendix Vol. I at 283a-317a. The 1980 Agreement granted ISI the "exclusive right to purchase or license ... CCC products ... for the purpose of reselling, leasing or renting such [p]roducts ... in the states of Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island, Vermont and Washington D.C.," *id.*, ¶ 1.1, the Marketing Territory.

The 1980 Agreement required ISI to use its "best efforts" to promote CCC products and to "take whatever actions ... CCC may reasonably request for the purpose of ensuring the effective distribution" of CCC products in the Marketing Territory. *Id.* at ¶ 3.1(a) and (b). The 1980 Agreement increased the number of full-time, fully trained employees ISI had to maintain to market CCC products and train proctors and teachers in the use of CCC products. *See id.*, ¶ 3.4.

Under the 1980 Agreement, ISI received a twenty percent discount on the prices of CCC products. *See* 1980 Agreement, ¶ 2.2 and Schedule B. This constituted a change from the previous discount arrangements. As stated, under the 1975 Agreement, ISI received a discount rate of twenty-five percent on certain CCC products. 1975 Agreement, ¶ III(A) and (B). The 1978 Agreement established a system for calculating the discount rate, whereby the discount rate started from a base of twenty percent and then was increased or decreased according to ISI's quarterly sales volume. 1978 Agreement, ¶ 2.2 and Schedule C.

The 1980 Agreement did not contain an automatic expiration provision, but, like the 1978 Agreement, allowed either CCC or

ISI to terminate the contract upon thirty days' notice after 1 July 1985. *Id.*, ¶ 9.4. The merger clause in the 1980 Agreement provided that the contract "constitutes the entire agreement" between the parties, that the contract "supersedes and terminates any and all prior agreements or contracts" and that "no change, termination, waiver or other modification of any of the provisions [thereof] shall be binding on CCC or ISI unless in writing and signed by a duly authorized representative." 1980 Agreement, Article XX.

8. The 1984 Agreement

On 12 July 1984, CCC and ISI entered into a fourth agreement (the "1984 Agreement") appointing ISI the exclusive re-seller[15] of certain CCC products in the Marketing Territory. 1984 Agreement, attached as Exhibit A to Rosdeitcher Aff., § 2.01; CCC 12G Statement, ¶ 1. By its terms, the 1984 Agreement expired on 31 July 1989.[16] 1984 Agreement, § 13.01; CCC 12G Statement, ¶ 2. The 1984 Agreement did not contain any provision requiring renewal or offering renewal as an option beyond the expiration date. Construction of the 1984

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[15] There is no explanation for why the 1984 Agreement began referring to ISI as a "re-seller" as opposed to a "distributor." Both the 1978 Agreement and the 1980 Agreement were entitled "Distributorship Agreement." The 1975 Agreement was simply entitled the "Agreement." The 1984 Agreement, however, was entitled "Reseller Agreement."

[16] Specifically, the 1984 Agreement stated:

> Term. This Agreement shall commence on the date first written above and shall, except as otherwise provided in this Part 13, continue in effect until July 31, 1989.

1984 Agreement, ¶ 13.01 (the "Termination Provision").

Agreement was to be governed by California law. 1984 Agreement, § 14.10.

The 1984 Agreement required ISI to "use its best efforts to promote demand for and to [r]e-sell [CCC's p]roducts to the [m]arket within the Territory," to "maintain adequate facilities for such purposes" and to "employ no less than four full-time sales representatives to accomplish this purpose." 1984 Agreement, § 6.01; Kaminer Certif., ¶ 50; ISI 12G Statement, ¶ 3.

ISI was restricted from selling any products which would compete with CCC products. ISI 12G Statement, ¶ 3. In order to qualify for certain discounts on CCC products, the 1984 Agreement required ISI to adhere to a sales quota for the Marketing Territory.[17] 1984 Agreement, §§ 4.02-4.03.

The 1984 Agreement granted certain software and hardware user licenses to ISI and authorized ISI "to use CCC's name, trademark and logo in its advertising, trade shows, public relations materials and manuals." 1984 Agreement, §§ 3.01-3.03, 6.02; Kaminer Certif., ¶ 50. It was provided that these licenses and rights terminated upon expiration of the 1984 Agreement. *Id.*, §§ 3.04, 6.02. The 1984 Agreement also stated: "ISI shall not enjoy any rights in the CCC name, its trademarks or logo." *Id.*, § 6.03; *see also id.*, §§ 11.01-11.02.

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[17] CCC explained this quota/discount system as follows:

> ISI has always had discounts based upon meeting certain quotas. In other words, the greater the sales volume, the greater the discount. This is a common method of pricing with respect to distributors within the computer industry. Distributors are compensated by discounts off the suggested retail price for the equipment.

Suppes Decl., ¶ 9.

The 1984 Agreement contained a "merger clause" which stated that the 1984 Agreement represented the entire agreement between the parties and superseded any other agreements.[19] *Id.*, § 14.08; CCC 12G Statement, ¶ 3.

ISI argues that even after signing the 1984 Agreement with its Termination Provision and Merger Clause, it maintained its understanding that the relationship with CCC was a continuous one. ISI Opposition Brief 5-6. CCC, on the other hand, insists it "did not promise ISI, nor did [it] and ISI mutually understand, that CCC would renew the 1984 Agreement upon its expiration on July 31, 1989." CCC 12G Statement, ¶ 4. CCC states further that, prior to this litigation, ISI never claimed that its distributorship of CCC products was to continue in perpetuity. Suppes Decl., ¶ 5.

9. Events Leading to the 1989 Agreement

CCC asserts that, during the course of the 1984 Agreement, it met with ISI and "expressed concern with ISI's performance and ability to compete" in the Marketing Territory. Commerce Clause Moving Brief at 6; *see also* Suppes Decl., ¶¶ 8, 10. CCC

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[19] Section 14.08 stated:

> Entire Agreement. This Agreement, including the Schedules attached hereto, represents the entire agreement between the parties relating to the subject matter hereof, and shall supersede any other agreements, whether oral or written. There are no understandings, representations or warranties of any kind except as expressly set forth in this Agreement. No waiver, alteration or modification of any of the provisions of or attachments to this Agreement shall be binding on any party unless in writing and signed by the party against whom enforcement of such waiver, alteration or modification is sought.

1984 Agreement, ¶ 14.08 (the "Merger Clause").

perceived that ISI was concentrating its sales efforts in only three states—Massachusetts, New Jersey and New York—and not adequately serving the seven other states and the District of Columbia (the "Eight States") within the Marketing Territory. Commerce Clause Moving Brief at 6; Suppes Decl., ¶ 8.

CCC states: "ISI was doing little or no business in ... Connecticut, Delaware, the District of Columbia, Maine, Maryland, New Hampshire, Rhode Island and Vermont." Commerce Clause Moving Brief at 6. For instance, it appears ISI made no sales in New Hampshire or Vermont from 1981 to 1989.[12] *Id.*; Kaminer Dep. Tr. at 315-16. In the same nine-year period, ISI made only two sales in Maine. Kaminer Dep. Tr. at 316. ISI, however, contends its sales force was beginning to make progress in Maine and Vermont. Kaminer Certif., ¶ 75. ISI states that in 1989 it consummated a sale in Maine of more than $300,000. *Id.* In addition, ISI was allegedly about to close a sale in Vermont of $170,000. *Id.*

On 14 January 1988, CCC wrote to ISI expressing concerns about ISI's poor selling performance in comparison with the CCC marketing efforts. Letter from CCC to ISI, dated 14 January 1988 (the "14 Jan. 1988 Letter"), attached as Exhibit C to the Suppes Decl. CCC compared the sales figures of ISI to those of its marketing department and found the comparison "quite dramatic." *Id.* at 2.

On 24 June 1988, CCC wrote ISI another letter which "review[ed] ISI's continued lack of growth and development since"

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[12] According to CCC, "[a]lthough the [E]ight [S]tates included approximately 30% of the students within [the Marketing T]erritory, they accounted for only 11% of ISI's sales revenues to CCC from 1985 through 1987." Commerce Clause Moving Brief at 6; *see also* Suppes Decl., ¶ 8.

the 14 Jan. 1988 Letter. Letter from CCC to ISI, dated 24 June 1988 (the "24 June 1988 Letter"), attached as Exhibit A to the Declaration of Ronald Fortune in Opposition to Plaintiff's Application for a Preliminary Injunction and Motion for Partial Summary Judgment and in Support of Defendant's Motion for Partial Summary Judgment, dated 26 June 1989 (the "Fortune Decl."), at 1. In the 24 June 1988 Letter, CCC compared its sales figures with those of ISI and stated:

> When we look at the three-year change from [1985] to [1988], the long term marketing efforts by ISI are very disappointing as compared to [CCC's] marketing performance. For learning stations, the three-year percentage change for ISI is a loss of 16%; for [CCC] corporate marketing, the three-year change is a dramatic growth of 142%.... The lack of ISI's growth is a serious problem.
>
> While examining ISI's sales performance, [CCC is] especially concerned about another set of data. There are a large number of states (including the District of Columbia) in your exclusive territory where there is little or no shipment of equipment.... Again, the performance of ISI is very disappointing.
>
> [W]e do appreciate the fact that ISI made its sales quota for 1987-88. Nevertheless, by comparison, [CCC] corporate marketing was 178% over quota.

Id. at 1-2.

Allegedly based upon ISI's performance, CCC determined that decreasing the area of the Marketing Territory was necessary. In the summer of 1988, CCC mailed to ISI a copy of a proposed agreement, which was to become effective 1 August 1988, and

asked ISI to sign the agreement and return it. Letter, dated 6 July 1988 (the "6 July 1988 Letter"), from CCC to ISI, attached as Exhibit E to the Suppes Decl. In the 6 July 1988 Letter, CCC (1) informed ISI that it desired to begin direct marketing of CCC products in the Eight States and (2) offered ISI a new exclusive distribution contract limiting ISI's Marketing Territory to New Jersey, New York and Massachusetts (the "Three State Marketing Territory"). *See* 6 July 1988 Letter; Kaminer Certif., ¶ 69.

ISI contends that until 1988, it had received no indication CCC was at all dissatisfied with ISI's performance.[20] Kaminer Certif., ¶ 67. To the contrary, ISI contends that in 1987, Suppes "insisted" that ISI increase its staff in the New England area. ISI Opposition Brief at 6; ISI 12G statement, ¶ 13. In response to Suppes' request, ISI did increase its staff, an undertaking, it contends, which was not specifically required by the terms of the 1984 Agreement. ISI Opposition Brief at 6; ISI 12G Statement, ¶ 13; Kaminer Certif., ¶ 59. ISI argues that this request further led it to believe CCC had no intent of terminating or altering the parties' relationship. ISI Opposition Brief at 6. In addition, ISI claims the 6 July 1988 Letter constituted CCC's first suggestion

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[20] ISI contends it was doing well in the entire Marketing Territory with $951,768 in sales in 1985, $850,508 in 1986, $1,225,598 in 1987, $1,529,431 in 1988 and projected sales for 1989 of $3,000,000 or more. ISI Opposition Brief at 6; Kaminer Certif., ¶ 73. ISI stresses that it did not account for its sales on a state-by-state basis but viewed the entire Marketing Territory as an integrated whole. Kaminer Certif., ¶ 25; *see id.* at ¶¶ 26, 28.

the Marketing Territory should be reduced.[21] ISI 12G Statement, ¶ 12.

In response to CCC's decision to reduce the Marketing Territory, ISI's representatives met with CCC personnel to explain the reason for the disparity between the sales figures of ISI and those of CCC. ISI states:

> [ISI] presented [CCC] with documentary evidence showing that the states with which [CCC] was concerned were either being significantly marketed by ISI and/or that there were factors ... which made it difficult to penetrate those states with respect to sales of [I]ntegrated [L]earning [S]ystems. These factors include the high percentage of small school districts in these states, the relative paucity of entitlement funds to purchase [I]ntegrated [L]earning [S]ystems, resistance of educators and taxing authorities to expenditure of funds in these smaller states, increased telephone charges in these smaller states which cause a disproportionate expense for the use of [I][ntegrated [L]earning [S]ystems and various similar factors.

Kaminer Certif., ¶ 68.

ISI states it received a letter on 19 December 1988, from CCC stating that if ISI did not sign a new agreement limiting ISI's exclusive distributorship to the Three State Marketing Territory by January 31, 1989, CCC would allow the 1984 Agreement to

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[21] It appears, however, that this was not the first time that the ISI marketing territory had been changed. For example, CCC indicates: "[T]he [e]astern Pennsylvania area was [once] within ISI's territory. Subsequently, this territory was removed." Suppes Decl., ¶ 6; *compare* 1975 Agreement, ¶ IA *with* 1978 Agreement, ¶ 1.1.

terminate on 31 July 1989; CCC would then market its products in the entire Marketing Territory. *Id.*, ¶ 69.

10. The 1989 Agreement

Instead of allowing the 1984 Agreement to lapse[22/] in accordance with its terms on 31 July 1989, the parties signed a new re-seller agreement on 30 January 1989 (the "1989 Agreement"), which limited ISI's exclusive distributorship to the Three State Marketing Territory. 1989 Agreement, attached as Exhibit I to the Rosdeitcher Aff., § 1.10; ISI 12G Statement, ¶ 14; CCC 12G Statement, ¶ 5.

In addition to reducing the Marketing Territory, the 1989 Agreement resulted in several other changes from the 1984 Agreement.[23/] The 1989 Agreement provided for a term of three years. *See id.*, § 13.1; 6 July 1988 Letter at 1. The 1989 Agreement, while continuing ISI's exclusive re-seller's right for CCC software and courseware in the Three State Marketing Territory, did not continue ISI's exclusive right to resell CCC hardware. 1989 Agreement, § 1.10; 6 July 1988 Letter at 2. CCC explained that anticipated agreements between CCC and two other computer companies would give those other computer companies the right to sell the hardware used to run CCC software and

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22/ CCC states that it "gave serious consideration to letting CCC's agreement with ISI ... lapse entirely when the [1984 Agreement] expired." Suppes Decl., ¶ 8.

23/ In addition to the differences discussed in the text, *infra*, the Complaint lists the following changes: the requirement that ISI provide CCC with information regarding ISI pricing and customer contracts, the requirement that ISI turn over to CCC all of its customer accounts in the Eight States and the elimination of the provision allowing ISI to purchase for resale the same CCC products offered to other resale marketers. Complaint, ¶ 35.

courseware, including the right to sell such hardware within the Marketing Territory. 6 July 1988 Letter at 2. Accordingly, CCC could no longer grant ISI an exclusive right to sell CCC hardware. *Id.*

The 1989 Agreement added restrictions on the activities which could be undertaken by Kaminer. The 1989 Agreement provided in pertinent part:

> [Kaminer], President of [ISI], hereby agrees that she will not directly or indirectly, through [ISI] or ownership in or as a director, officer, employee or independent contractor of any other entity, take any action, enter into any agreement or conduct any activity which ISI would otherwise be restricted from taking as set forth in Section 12 [of the 1989 Agreement].

Id., § 12.4. ISI is displeased with this new provision because, it claims, it prohibits personal involvement of Kaminer in any other enterprise, even as a passive investor in an unrelated industry. ISI Opposition Brief at 37 n.11. The 1989 Agreement also required Kaminer to act as a personal guarantor in particular situations:[24]

> CCC is willing to enter into [the 1989 Agreement] with ISI only if [Kaminer] provides her personal guaranty for the faithful performance of all the terms and conditions of the [1989 Agreement] and to the payment of any and all the

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[24] CCC claims it added this requirement after its distributor for the southern United States failed to pay its bills and caused CCC to terminate their relationship. CCC Moving Brief at 21 n.16; 6 July 1988 Letter at 2.

> terms and conditions of the [1989 Agreement] should ISI's financial condition detrimentally change.

1989 Agreement, § 12.5.

ISI also takes issue with the discount quotas in the 1989 Agreement. The 1989 Agreement changed the previous discount arrangement by providing that discount rates on the CCC products would be established by the "mutual agreement" of the parties on an annual basis.[2/] *Id.*, § 4.3. The previous discount arrangement set forth in the 1984 Agreement gave ISI a set discount rate of twenty percent on CCC software, courseware and hardware and an adjustable rate, ranging from twenty to thirty percent depending on how much ISI spent annually on CCC products, on particular items of CCC hardware. 1984 Agreement, §§ 4.2, 4.3 and Schedule D.

CCC explained in the 6 July 1988 Letter it was altering the structure of the discount arrangement because "the changing nature of the business is such that [CCC] will need to negotiate a yearly discount schedule. [CCC] certainly plan[s] to give [ISI] the very best terms we can in order to facilitate [ISI's] business." 6 July 1988 Letter at 2.

The 1989 Agreement also included a termination quota which allowed CCC to terminate the 1989 Agreement upon the occurrence of any of the following:

> (1) if the total annual net revenue received from the states of Massachusetts, New Jersey and New York by CCC from ISI in CCC fiscal year ending March 31, 1990 decreases by 20%

[2/] It appears, however, that the discount arrangement was changed with each new contract entered by the parties. *See* 1975 Agreement, ¶ III(A); 1978 Agreement, ¶ 2.1; 1980 Agreement, ¶ 2.2; 1984 Agreement, §§ 4.02-4.03.

> or more from the total annual revenue received from these three states by CCC from ISI in CCC fiscal year 1989 year; or
>
> if the total annual net revenue received from the states of Massachusetts, New Jersey, and New York by CCC from ISI in any CCC fiscal year decreases by 50% or more from the total annual net revenue received from these three states by CCC from ISI between April 1, 1988 and March 31, 1989.

1989 Agreement, § 13.2(d). The termination quota in the 1989 Agreement was virtually identical to that in the 1984 Agreement. *Compare* 1989 Agreement, § 13.2(d) *with* 1984 Agreement, § 13.02(d).

Although the termination and discount quotas set forth in the 1989 Agreement were nearly identical to those in the 1984 Agreement, ISI contends those provisions set "unreasonable performance standards."[2] ISI Opposition Brief at 35-38. ISI claims those provisions are particularly unreasonable when combined with the reduction of its marketing territory to the Three State Marketing Territory. ISI Opposition Brief at 36-37. ISI, however, does not dispute that it was able to meet both the termination and discount quotas for 1989 and 1990. *See id.* at 37; CCC Moving Brief at 13. ISI also claims the restrictions on Kaminer and the requirement that Kaminer be a guarantor of the 1989 Agreement are unreasonable. ISI Opposition Brief at 37 n.11.

According to ISI, it signed the 1989 Agreement "[u]nder business duress created by CCC, and without waiving its rights to

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[2] CCC, on the other hand, contends the 1989 Agreement did not contain any provision which imposed any unreasonable standards of performance on ISI. CCC 12G Statement, ¶ 6.

test the legality of the [1989 Agreement]." Complaint, ¶ 41. ISI describes this alleged business duress as follows:

> CCC ... demanded that ISI sign the [1989 Agreement] and deliver it to CCC by January 31, 1989, together with certain ISI financial statements and the personal guarantee of [ISI's principal] Phyllis Kaminer. If ISI [did] not, CCC ... threatened to revoke its offer and begin immediately to make alternate marketing arrangements to distribute its [p]roducts in New Jersey, New York and Massachusetts.
>
> CCC ... refused to enter into any meaningful negotiation to change or alter the terms of the proposed contract....
>
> The offer of the [1989 Agreement] by CCC, CCC's refusal to negotiate any of its terms and the ultimatum basis on which it was presented are part of CCC's deliberate and intentional plan to destroy ISI and its business and appropriate the goodwill and property rights that ISI has created for itself in its territory since 1974....
>
> In furtherance of this plan to destroy ISI, CCC ... refused to provide ISI with any necessary technical, pricing and discount information with respect to the new IBM CCC hardware program now being offered ... unless and until ISI execute[d] and deliver[ed] the [1989 Agreement] without change by ISI, together with the requisite financial information.

Complaint, ¶¶ 36-37, 39-40; *see also* Kaminer Certif., ¶¶ 68-69.

11. The Alleged Impact of the 1989 Agreement on ISI

Over the years, ISI claims to have invested, on average, over $200,000 per year on its sales and promotional activities for CCC products in the Marketing Territory. Kaminer Certif., ¶ 46; *see id.*, ¶ 61-65, 75; Kaminer Supplemental Certif., ¶ 5. In the process, ISI contends it developed "significant good will [sic] for CCC" and "established an 'installed base of customers' in the Marketing Territory whose continuing renewals of their licenses and upgrades of their CCC systems generate on-going profits." ISI 12G Statement, ¶ 9; Kaminer Supplemental Certif., ¶¶ 2, 14, 34.

ISI complains the elimination of the Eight States from the Marketing Territory deprives it of the fruits of its efforts in those areas. ISI argues that because the lead time for a sale of Integrated Learning Systems averages from six months to two years of promotional effort on the part of ISI, CCC is in a position to benefit in the future from the legwork ISI has already done in the Eight States. Kaminer Certif., ¶ 65; ISI 12G Statement, ¶ 10. Accordingly, ISI contends it loses all of the sales and promotional efforts expended in the Eight States, and CCC stands to receive the benefit of its hard work. ISI 12G Statement, ¶¶ 9, 11, 15.

B. The Complaint

On the same day ISI signed the 1989 Agreement, 30 January 1989, it filed this lawsuit.[27] *See* Complaint. The Complaint

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[27] The Complaint was filed in the Superior Court of New Jersey, Chancery Division, Passaic County. *See* Complaint at 1. On 6 February 1989, the case was removed to this court pursuant to 28 U.S.C. § 1441. *See* Notice of Removal, filed 6 February 1989, at 1. Jurisdiction is alleged pursuant to 28 U.S.C. § 1332. *Id.*

alleges that, although the 1984 Agreement contained a specific expiration date, it was "always understood that the relationship between [ISI and CCC] would not be terminated except for good cause." Complaint, ¶¶ 14, 18. The Complaint further alleges that, consistent with the 1984 Agreement, "ISI has fully and completely complied with the requirements of its arrangements with CCC and has successfully utilized its best efforts to develop a demand for CCC's products in the geographical area assigned to it." *Id.*, ¶ 24.

In the Complaint, ISI contends, *inter alia*, that the 1984 Agreement constituted a franchise agreement under the New Jersey Franchise Practices Act, N.J.S.A. §§ 56:10-1, *et seq.* (the "Franchise Practices Act"). Complaint, ¶ 32. ISI further alleges CCC's actions with respect to the 1989 Agreement—namely, failing to renew the 1984 Agreement without good cause and "attempting to impose unreasonable standards of performance upon ISI"—violate sections 56:10-5 and 56:10-7 of the Franchise Practices Act. *See* Complaint, ¶ 14.

The Complaint includes seven counts in which ISI alleges CCC's refusal to renew the 1984 Agreement and its demand that ISI sign the 1989 Agreement constitutes (1) a violation of the Franchise Practices Act (Count One), (2) a breach of the 1984 Agreement (Count Two), (3) a breach of the implied covenant of good faith and fair dealing (Count Three), (4) tortious interference with ISI's business relationships with prospective customers (Count Four), (5) unfair competition (Count Five), (6) unjust enrichment on CCC's part (Count Six) and (7) a breach of the fiduciary duty CCC owed ISI by virtue of "vast expertise and knowledge concerning the market and future markets for computer assisted instructional products" (Count Seven) (collectively, the "Common Law Counts"). *Id.*, ¶¶ 1-66.

For each count, ISI seeks; (1) an injunction restraining CCC from terminating the 1984 Agreement, (2) damages sustained as a result of CCC's violation or breach of the 1984 Agreement, (3) prejudgment and postjudgment interest, (4) a declaration of the rights and liabilities of CCC and ISI under "their relationship," (5) compensatory damages, (6) punitive damages, (7) attorneys' fees and (8) costs. *Id.*, ¶¶ 44, 47, 50, 53, 56, 59, 66.

C. Procedural History

In June 1989, ISI moved for a preliminary injunction to prevent the 1989 Agreement from taking effect such that the Marketing Territory would be curtailed to the Three State Marketing Territory. CCC opposed the motion for preliminary injunction and cross-moved for partial summary judgment on Count One. *See Instructional Systems II*, 826 F.Supp. at 838. In support of its cross-motion for partial summary judgment, CCC argued that applying the Franchise Practices Act to this case would be an unconstitutional restraint on interstate commerce (the "Commerce Clause Argument"). *See* Commerce Clause Moving Brief at 12.

1. Abstention

In response to the Commerce Clause Argument posed by CCC, ISI moved to have this court abstain and remand to the New Jersey Superior Court certain issues in the case pertaining to the Franchise Practices Act, pursuant to *Railroad Commission of Texas* v. *Pullman Co.*, 312 U.S. 496 (1941).

By an opinion, filed 20 July 1989 ("*Instructional Systems I*"), the ISI motion for abstention was granted. *Id.*, slip op. at 3. However, only a limited number of issues arising out of Count One were remanded to state court. *Id.* at 16. Specifically, the

following issues were identified for resolution by the New Jersey state courts: (1) Whether the Franchise Practices Act has extraterritorial reach beyond the state of New Jersey and, if so, to what extent and (2) what are the definitions and standards of "community of interest," "license" and "place of business" under the Franchise Practices Act. Order, filed 27 July 1989 (the "Remand Order"), at 1.

The Remand Order was subsequently clarified to allow the New Jersey state courts to determine (1) whether there is a "community of interest" between ISI and CCC and (2) whether ISI has a "place of business" within the meaning of the Franchise Practices Act. Transcript of Proceedings, dated 28 July 1989 (the "28 July 1989 Tr."), at 4. No other issues were remanded to the New Jersey State courts.

Jurisdiction was retained by this court to apply the law established by the New Jersey courts to the facts of this case, to resolve any constitutional challenge to the Franchise Practices Act and to determine any application for injunctive relief. Remand Order at 1-2. Specifically, the Remand Order stated:

> Except as so expressly stated herein, this Court retains and reserves unto itself without limitation:
>
> (a) Jurisdiction over this matter and the parties hereto;
>
> (b) Application of the principles of law determined by the state court to the facts of this case;
>
> (c) Any constitutional challenge to the Franchise Practices Act; and
>
> (d) Any application for injunctive relief.

Id. The remaining counts of the Complaint were administratively terminated pending the state court resolution of the remanded issues arising from Count One. *Id.* at 2.

2. Resolution of Certain Franchise Practices Act Issues by the New Jersey State Courts

a. The Chancery Division

The determination of the remanded issues began in New Jersey Superior Court, Chancery Division, Passaic County. Upon remand of the case to the state court, ISI filed a complaint in the Chancery Division on 27 July 1989 (the "Second Complaint") seeking declaratory relief. Second Complaint, attached as Exhibit 7 to ISI Vol.I. In the Second Complaint, ISI essentially repeated its allegations giving rise to Count One and omitted the Common Law Counts. *Id.* The Chancery Division consolidated the Second Complaint and the case on remand "[t]o avoid confusion and to insure [the Remand Order] applies...." Ch.Div. Tr. at 4-5.

In addition to filing the Second Complaint, ISI moved in the Chancery Division for (1) summary judgment as to whether the 1984 Agreement was a franchise agreement and whether the Franchise Practices Act applied to the non-renewal of the 1984 Agreement, (2) a declaration that the 1984 Agreement was a franchise agreement under the Franchise Practices Act, that certain changes in the 1989 Agreement constituted unreasonable standards of performance under the act and that CCC violated the Franchise Practices Act by not renewing the 1984 Agreement, and (3) preliminary injunctive relief. ISI's Brief in Support of its Application for a Determination of Certain Rights Under the New Jersey Franchise Practices Act, dated 12 October 1989, included in CCC Appendix Vol. IV, at 1637a.

In opposition to ISI's motion, CCC argued that (1) New Jersey law did not apply in light of the choice of law provision in the 1984 Agreement, (2) the Franchise Practices Act did not apply to the out of state operations of New Jersey franchises, (3) the 1984 Agreement did not require ISI to maintain a "place of business" in New Jersey and (4) ISI is not a franchisee because there was no "community of interest," ISI's investments could not be construed as franchise specific investments, and ISI had not been granted a license by CCC. Defendant Computer Curriculum Corporation's Reply Brief in Opposition to Plaintiff Instructional System, Inc.'s Notice of Application for Determination of Rights Under the New Jersey Franchise Practices Act, dated 27 September 1989 (the "CCC Ch.Div. Brief"), included in CCC Appendix Vol. IV at 1465a-1490a. In addition, CCC expressly reserved its right to have the Commerce Clause issue and any application of the Franchise Practices Act to the particular facts of this case decided in Federal court. *Id.* at 1469a-1471a.

The Chancery Division, in a fact-intensive decision issued from the bench, *see generally* Transcript of Proceedings before the Honorable Arthur C. Dwyer, 30 October 1989 (the "Ch.Div. Tr."), attached as Exhibit E to the ISI Supplemental Appendix, issued a declaratory judgment stating the following:

> a) as a matter of law, the [Franchise Practices] Act applies to the [1980 Agreement] and [the 1984 Agreement];
>
> b) CCC in the [1984] Agreement[] grants to ISI a "license" as that term in used in the [Franchise Practices] Act;
>
> c) the [1984] Agreement[] and the acts of the parties thereunder create a "community of interest" as that term is used in the [Franchise Practices] Act;

> d) ISI has maintained a "place of business" as that term is used in the [Franchise Practices] Act;
>
> e) ISI and CCC "contemplated" at the time the [1984] Agreement[] [was] executed that ISI would ... maintain a "place of business" within the State of New Jersey ...;
>
> f) the [1984] Agreement[] constitute[s] "franchises" as that term is used in the [Franchise Practices] Act; and
>
> g) ... the Legislature did not intend the law of New Jersey to have extraterritorial effect....[2/]

Order of Final Judgment, filed 2 November 1989, attached as Exhibit F to the ISI Supplemental Appendix, at 2-3.

[2/] In contrast, the Remand Order, as modified by the 28 July 1989 Tr., remanded only the following issues to the state courts:

> (1) Whether the Franchise Practices Act has extraterritorial reach beyond the State of New Jersey and, if so, to what extent;
>
> (2) what is the definition and standard of "license" under the Franchise Practices Act;
>
> (3) whether there is a "community of interest" between ISI and CCC; and
>
> (4) whether ISI has a "place of business" within the meaning of the Fran[2/]chise Practices Act.

See Remand Order at 1-2; 28 July 1989 Tr. at 4. No other issues were remanded to the New Jersey state courts. Accordingly, the order of the Chancery Division strayed past the boundaries of the Remand Order by determining that (1) ISI had been granted a license by CCC and (2) the 1984 Agreement constituted a franchise agreement under the Franchise Practices Act.

At the outset of its opinion, the Chancery Division determined that it could "simply define the words as the outline of the [Remand Order] suggest[s], but as this Court has noted, Judge Lechner expects the facts to be considered."[2/] Ch.Div. Tr. at 6.

[2/] The Chancery Division had earlier stated:

> Judge Lechner further explained that the State Court would have to look at the facts of the case. Thereafter, [ISI] filed a complaint for declaratory judgment.

Ch.Div. Transcript at 4 (citing the 28 July 1989 Transcript). The Chancery Division apparently relied on the following portion of the 28 July 1989 Transcript:

> THE COURT: How do you expect the state court to pass on community of interest, license [and] extraterritoriality unless they look at facts?
>
> MR. AUERBACH: The facts of this specific case?
>
> THE COURT: What other facts would you be talking about?
>
> MR. AUERBACH: I guess they would look at those facts.
>
> THE COURT: Fine. We're in accord.

28 July 1989 Transcript at 5.

However, during the parties' appearance before this court on 9 November 1989, the following was also stated:

> My opinion and order [the Remand Order] addressed the concept of the application of the Franchise [Practices Act] beyond the territorial limits of the state of New Jersey and asked for concepts of definitions of community[] of interest, et cetera.
>
> That is what I hoped I would go through the declaratory judgment application here. [I]f [the] complaint [filed in the state court] was (continued...)

The Chancery Division initially addressed the choice-of-law provision in the 1984 Agreement which required that the 1984 Agreement be governed by the laws of California. The provision was found to be unenforceable because it violated New Jersey public policy and attempted to evade the application of the Franchise Practices Act. *See id.* at 7-20, 73-74.

The court then discussed what, in its view, were the relevant cases on the issues of license and "community of interest." Ch.Div. Tr. at 45-53 (citing *Neptune T.V. & Appliance Serv.* v. *Litton Microwave Cooking Prods. Div. Litton Sys., Inc.*, 190 N.J.Super. 153 (App.Div. 1983); *Finlay & Assocs.* v. *Borg-Warner Corp.*, 146 N.J.Super. 210 (Law Div. 1976), *aff'd*, 155 N.J.Super. 331 (App.Div.), *certif. denied*, 77 N.J. 467 (1978); *Business Incentives* v. *Sony Corp. of Am.*, 397 F.Supp. 63 (S.D.N.Y. 1975)). The Chancery Division then cited the following facts which apparently led it to find ISI had been granted a license: (1) ISI was given permission to use the CCC name, trademark and logo; (2) ISI was required to promote CCC products at its own expense; (3) ISI was prohibited from selling competitive goods, (4) ISI was required to train and instruct the purchasers of CCC products; (5) ISI was required to respond to customer operational

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[22](...continued)

particularized to the facts of this case, you may have some problems as vis-a-vis the remand from me.

* * *

I don't think there was anything that was ever said to suggest that Judge Dwyer would make rulings that would be res judicata or collateral estoppel in the nature of this case.

Transcript of Proceedings, 9 November 1989, at 10, 11.

or use problems; (6) ISI received annual license fees paid by CCC customers to ISI each year the CCC system was in place, a portion of which ISI then paid to CCC; and (7) CCC exercised supervision over ISI. Ch.Div. Tr. at 53-55.

After discussing the facts, the Chancery Division generally defined "license" as being

> broader than a simple common law contract to use the trade name and mark. Without attempting to write a scholar's definition of the meaning, this Court concludes that in any given situation the meaning has to be considered in light of the Federal cases construing the Federal statutes.... [T]hat body of law is relevant in determining whether a license exists and what the duties of the respective parties are under the agreement comes in to bear and has to take account what the respective responsibilities under these laws are in respect to those activities.

Ch.Div. Tr. at 56.

The court then went on to determine that ISI and CCC had a community of interest. It stated that the "community of interest" element was what converted a licensor/licensee relationship into one warranting protection under the Franchise Practices Act. *See* Ch.Div. Tr. at 45-53.

The court found the circumstances of the relationship between ISI and CCC warranted the application of the Franchise Practices Act because "[t]ermination [of the 1984 Agreement] can benefit CCC to ... its advantage greater than any freedom to re-enter the field of competition that ISI could get." Ch.Div. Tr. at 71-72. Specifically, the court made reference to the following facts:

[I]n looking at the community of interest, [and] the concept of mutual dependence, one has to look not only at the ongoing relationships ... but where the license will be, if the conditions for termination are not satisfied and, in this case, at least since 1980, ISI has been [ ] practically prohibited from engaging in any other activity except the sale of CCC products. That certainly makes it dependent upon CCC. It has been required to devote full time and energy to the sale and promotion not only of product, but of the name and of the good will of CCC. It has had to gear, pursuant to contractual provisions, at least as now tendered, that its own products would have to be ... at least consistent or somehow configured so that it would only work with CCC products.

[I]f there is termination, all existing license agreements, maintenance contracts will be shifted automatically, the unpaid balances, without compensation to CCC, that certainly leaves an entity such as ISI that has been compelled to engage exclusively in the promotion of the CCC products, and the CCC name since 1980 in a position where it would be literally free to start from ground zero, from the field of competition, that the good will that has been built in the service area, the contacts made in the install base would be totally in the control, and again, without compensation [to] ISI, but totally for CCC.

* * *

The Court finds that the ISI/CCC relationship is not one where the product is dropped off at the customer's door and there is no further ongoing relationship. As outlined above, it is expected to be and required to be ongoing, particularly on the part of ISI, but at ISI's expense and to promote the reputation and good will of CCC.

Ch.Div. Tr. at 67-70.

The Chancery Division also looked at the extraterritorial impact of the Franchise Practices Act and determined as follows:

> All New Jersey regulates, all that it is interested in regulating is solely those relationships that fit within what the Legislature has prescribed. That's all that it has to do in order to protect that group that it seeks to protect and regulate. Those who have a contact in New Jersey, the wrongful termination of which will recognize some harm[ ].... and that impact will be in New Jersey and it will have an adverse effect in New Jersey.

Ch.Div. Tr. at 74-75. The Chancery Division went on to state that the legislature "was not concerned with extraterritorial effect" and was not seeking to give its laws extraterritorial effect. *Id.* at 75. In addition, the court stated: "[T]o the extent that the laws of those other states have a material interest in this relationship in any way [that] is inconsistent with [the Franchise Practices Act], the laws of those other states ... will apply." *Id.*

b. The Appellate Division

CCC appealed the Chancery Division decision to the Appellate Division of the Superior Court on 13 November 1989. CCC's Notice of Appeal, dated 13 November 1989, attached as Exhibit 17 to ISI Vol.II. On appeal, CCC argued the Chancery Division had committed the following errors: (1) decided issues which were outside the scope of the Remand Order,[29] (2) applied

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[29] CCC argued the district court only remanded the following issues to the state courts: (1) whether the Franchise Practices Act had extraterritorial reach beyond (continued...)

the Franchise Practices Act despite the fact that California, not New Jersey, law applies and the Franchise Practices Act does not apply to out of state franchise operations and (3) determined that the 1984 Agreement was a franchise agreement despite the fact CCC never obligated ISI to maintain a "place of business" in New Jersey and ISI did not maintain a "place of business" in New Jersey, ISI was never granted a license and there was no

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[29](...continued)
the state of New Jersey and (2) the definition of the terms "community of interest," "license" and "place of business" as used in the Franchise Practices Act. Brief on Behalf of Appellant, dated 2 January 1990 (the "CCC App.Div. Brief"), attached as Exhibit 14 to the CCC Exhibits, at 7. CCC asserted that the district court had "retained jurisdiction over the matter and the parties, including the power to apply the law, as determined by the New Jersey courts, to the facts of the case; to rule on any constitutional challenges to the [Franchise Practices] Act; and to rule on any applications for injunctive or other interim relief." *Id.*

ISI countered that the issues decided by the Chancery Division were properly before it. *See* Responding Brief and Appendix on Behalf of Plaintiff-Respondent Instructional Systems, Inc. (the "ISI App.Div. Brief"), attached as Exhibit 32 to ISI Vol.III, at 17-20. First, ISI argued that the New Jersey Constitution gave the Chancery Division jurisdiction to hear the issues raised by the Second Complaint. *Id.* at 17. Second, ISI contended CCC had waived any right it had to return to Federal court by submitting the issues to the Chancery Division for a determination in its favor. *Id.* at 18. Third, ISI asserted that if CCC were correct in its argument that the state court was prohibited from any fact-finding, the Chancery Division decision would constitute an advisory opinion "devoid of any factual background." *Id.* at 19. ISI then argued the New Jersey state courts are prohibited from issuing advisory opinions. *Id.* (citing *New Jersey Ass'n for Retarded Citizens, Inc.* v. *New Jersey Dep't of Human Servs.*, 89 N.J. 234, 241 (1982)).

In *dictum* and without explanation, the Appellate Division stated that CCC's argument that the Chancery Division had "overstepped the limits of its jurisdiction by deciding issues that the District Court's abstention order did not explicitly authorize it to decide," was "without merit." *Id.* at 58.

community of interest between ISI and CCC. *See* CCC App.Div. Brief.

The Appellate Division reversed the decision of the Chancery Division. *See Instructional Systems. Inc.* v. *Computer Curriculum Corp.*, 243 N.J.Super. 53, 62 (App.Div. 1990) ("*App. Div. Instructional Systems*"). The Appellate Division held ISI could not be a franchisee because CCC had not granted ISI a "license" as that term is used within the Franchise Practices Act. *Id.* at 58-62. Specifically, the court stated:

> [N]one of the activities which ISI actually engages in would allow a customer to conclude that there is a special connection between CCC and ISI of the type found in genuine franchise arrangements. While ISI refers to CCC in its advertising and promotional literature, it does not use CCC's name as its own. Furthermore, there are no signs or other types of advertising outside of ISI's place of business that mention CCC. These facts suggest that ISI is merely an independent contractor that happens to sell CCC products.

Id. at 61. Accordingly, the Appellate Division found that, in the absence of a "license," the relationship between CCC and ISI could not be considered a franchise within the meaning of the Franchise Practices Act. *Id.* Because the court determined that ISI's and CCC's relationship did not fall under the Franchise Practices Act, the court

> decline[d] to consider whether the [Franchise Practices] Act, if it were applicable to the relationship between CCC and ISI, could have been applied extraterritorially.

Id. at 61-62.

c. The New Jersey Supreme Court

Following the Appellate Division decision, ISI appealed to the New Jersey Supreme Court. ISI argued the Appellate Division's reversal of the Chancery Court's decision was erroneous for the following reasons: (1) the holding frustrated the purpose of the Franchise Practices Act by too narrowly construing the word "license"; (2) the decision did not follow the previous Appellate Division decision in *Neptune T.V.*, 190 N.J.Super. 153; and (3) the Appellate Division erroneously considered factors other than the 1984 Agreement in determining whether ISI was a franchise. Brief and Appendix of Plaintiff-Petitioner, attached as Exhibit 38 to ISI Vol.III.

In *Instructional Systems. Inc.* v. *Computer Curriculum Corp.*, 130 N.J. 324 (1992) ("*N.J. Sup. Ct. Instructional Systems*"), it appears the New Jersey Supreme Court reached a decision on the remanded issues as well as issues which were not remanded.

The New Jersey Supreme Court stated that it had before it the following questions:

> (1) What is a franchise under the New Jersey Franchise Practices Act; *id.* at 338
>
> (2) Does the [Franchise Practices Act] apply at all in view of the parties having chosen California law to govern the interpretation of their contract; *id.* at 341
>
> (3) What is the appropriate standard of review; *id.* at 346
>
> (4) Does the business relationship between CCC and ISI constitute a franchise protected under the New Jersey Franchise Practices Act; *id.* at 347

(a) Did the 1984 Reseller Agreement contemplate that ISI would maintain a place of business in New Jersey; *id.*

(b) Does the record support the trial court's finding that ISI has been granted a "license"; *id.* at 351

(5) If there is a New Jersey franchise, does the Act have extraterritorial reach to the franchise activities in states other than New Jersey.[21/] *Id.* at 356

[21/] Again, it appears the state court decided issues beyond those remanded. The Remand Order, as modified by the 28 July 1989 Tr., sent only the following issues to the state courts:

(1) Whether the Franchise Practices Act has extraterritorial reach beyond the State of New Jersey and, if so, to what extent;

(2) what is the definition and standard of "license" under the Franchise Practices Act;

(3) whether there is a "community of interest" between ISI and CCC; and

(4) whether ISI has a "place of business" within the meaning of the Franchise Practices Act.

See Remand Order at 1-2; 28 July 1989 Tr. at 4. No other issues were remanded to the state courts. The New Jersey courts were not asked to define "franchise" or determine the choice of law question. It further appears that the issues of whether the relationship between ISI and CCC is a franchise and the appropriate standard under which that determination should be made were inappropriately addressed.

The same observation is made concerning the Commerce Clause issue.

The New Jersey Supreme Court began by defining the term "franchise" under the Franchise Practices Act stating:

> Although franchise arrangements take many different forms, "'in its simplest form, franchising involves a company with a product or service which arranges for a group of dealers to handle its distribution. The company with the product, product line or service is known as the franchisor, and the dealers who acquire the right to sell the product or service exclusively are known as franchisees.'"

Id. at 338 (citations omitted). The court also cited the Federal Trade Commission definition of a franchise:

> "[A]ny continuing commercial relationship *** whereby a person (hereinafter 'franchisee') offers, sells, or distributes *** goods, commodities, or services which are: (1) identified by a trademark, service mark, trade name, advertising or other commercial symbol designating another person (hereinafter 'franchisor')." The FTC definition requires further that the "franchisor exert[] or [have] authority to exert a significant degree of control over the franchisee's method of operation."

N.J. Sup. Ct. Instructional Systems, 130 N.J. at 339-40 (quoting 1 Gladys Glickman, *Franchising* § 2.01 at 2-3 (1969)).

The court next determined that the trial court did not err by applying New Jersey law, despite the terms of the 1984 Agreement providing that California law would govern.[22] *Id.* at 341-46. The

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[22] The choice of law issue was not remanded to the state courts in the Remand Order. The issue of whether New Jersey law applies, in the event the Franchise (continued...)

court reasoned that New Jersey had a strong interest in protecting its franchisees. *Id.* at 345. In particular, the court found that the following factors illustrated New Jersey's "strong interest": the "franchise" was located in New Jersey; the majority of ISI employees resided in New Jersey; and the "franchise-specific investments" related to assets located in New Jersey. *Id.* at 345-46.

The New Jersey Supreme Court then determined the relationship between ISI and CCC contained the necessary elements to constitute a franchise within the meaning of the Franchise Practices Act.[22/] First, the court determined the Hackensack Facility "could be found to constitute a 'place of business' under the [Franchise Practices] Act." *Id.* at 351. The court determined that the "place of business" requirement could be satisfied under the Franchise Practices Act if "the contract required a place of business in New Jersey or [if] the parties reasonably anticipated that the franchise would establish a New Jersey place of business." *Id.* at 348. The court then held "[t]here was sufficient evidence to support a finding of fact that the 1984 Agreement 'contemplated' that ISI would have a 'fixed business location' in New Jersey." *Id.* at 348-51.

The court next turned to the issue upon which the Appellate Division reversed the trial court—whether ISI had been granted a license. The court compared the following facts to those in the case of *Neptune T.V.*, 190 N.J.Super 153:

22/(...continued)
Practices Act is applicable, however, was raised by CCC without reservation and appears to have been fully litigated in the state courts.

22/ The issue whether the relationship between CCC and ISI constitutes a franchise within the meaning of the Franchise Practices Act was not remanded to the state courts in the Remand Order.

> ISI has established a relationship with CCC that is quite different from that of a department store that sells Apple or IBM computers. Section 6.02 of the 1984 [Agreement] *required* ISI to "*use its best efforts* to maintain and *promote* CCC's name, trademark and logo on the [p]roducts." The CCC computerized-educational-learning system is not an "off-the-shelf" product that can be purchased at the neighborhood appliance store. Rather it is a unique combination of hardware and software whose identity is integrally related with that of ISI. Significantly, the 1984 [Agreement] prohibited ISI from selling *any products* competitive with CCC products. Moreover, CCC prohibited ISI from developing or designing any products that might compete with CCC's products. Furthermore, CCC obligated ISI to educate and train users of CCC products on a continuing basis.

N.J. Sup. Ct. Instructional Systems, 130 N.J. at 353-54 (emphasis in original).

The court then determined the relationship between CCC and ISI satisfied the requirements of *Neptune T.V.*.

> To transpose the words of *Neptune T.V.*, "We are satisfied this hallmark was present here since by [CCC's] designation of [ISI] as an [exclusive distributorship] and its [requirement]" that ISI maintain and promote CCC's name, trademark, and logo, CCC "gave its imprimatur to [ISI's] business enterprise in respect of [CCC's] product and induced the consuming public to expect from [ISI] a uniformly acceptable and quality controlled service endorsed by [CCC] itself."

N.J. Sup. Ct. Instructional Systems, 130 N.J. at 354 (quoting *Neptune T.V.*, 190 N.J.Super. at 160-61). The court concluded it "was satisfied that the trial court had sufficient evidence to find that the relationship between ISI and CCC satisfied the *Neptune T.V.* standard." *N.J. Sup. Ct. Instructional Systems*, 130 N.J. at 355. The court reached this result despite the fact ISI conducted business under its own name and did not pay a franchise fee to CCC. *Id.* at 353-55.

The New Jersey Supreme Court determined sufficient facts existed so that it could not be said "the trial court erred in finding that the CCC-ISI relationship showed a community of interest." *Id.* at 356-66. Citing *Neptune T.V.*, the court described the community of interest standard as being "based on the complex of mutual and continuing advantages which induced the franchisor to reach his ultimate consumer through entities other than his own which, although legally separate, are nevertheless economically dependent on him." *N.J. Sup. Ct. Instructional Systems*, 130 N.J. at 358 (citing *Neptune T.V.*, 190 N.J.Super. at 163). The court further explained that the "community-of-interest requirement addresses the inequality of bargaining power between the parties and is critical in distinguishing franchises from other types of businesses." *Id.* at 356. The court stated:

> The [Franchise Practices] Act's concern is that once a business has made substantial franchise-specific investments it loses all or virtually all of its original bargaining power regarding continuation of the franchise. Specifically, the franchise cannot do anything that risks termination, because that would result in a loss of much or all of the value of its franchise-related investments.

Id. at 357.

The court then reviewed the facts of this case and determined, *inter alia*, (1) ISI had made "franchise-specific investments"—such as purchasing copyrighted computer software—and (2) ISI had developed goodwill and contacts, none of which could be used if the relationship with CCC ended. *Id.* at 362-66. The court also pointed to the following facts as demonstrative of the interdependence of CCC and ISI: the requirement that ISI and its personnel direct all their energies to developing customers for CCC products, the requirement that ISI maintain training programs for CCC product users, the prohibition against ISI selling any competitive products, CCC's right to monitor ISI's books and the evidence which revealed that ISI customers considered ISI and CCC synonymous. *Id.* at 364-65.[24]

Turning to the issue of whether the Franchise Practices Act has extraterritorial reach, the New Jersey Supreme Court determined the act had, at best, only incidental extraterritorial effect. *Id.* at 370-71. The court began by recognizing two facts: (1) there was nothing to indicate CCC intended or agreed that the Franchise Practices Act would apply to CCC's activities in states other than New Jersey and (2) New Jersey has no power to regulate commerce that occurs entirely beyond its borders. *Id.* at 367 (citing *Healy* v. *Beer Institute*, 491 U.S. 324 (1989); *Edgar* v. *MITE Corp*, 457 U.S. 624 (1982)).

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[24] The court did not go on to state that the relationship between ISI and CCC actually constitutes a franchise, but in its conclusion, the court reinstated the Chancery Division decision that the relationship is a "franchise." *Id.* at 373-74.

Two dissented from the decision in *N.J. Sup. Ct. Instructional Systems* on the ground that the relationship between CCC and ISI is not a franchise within the meaning of the Franchise Practices Act. 130 N.J. at 380 (Clifford, J., and D'Annunzio, J.A.D. (temporarily assigned), dissenting).

The New Jersey Supreme Court, nevertheless, distinguished *Healy* and *Edgar* from the facts before it. The court stated:

> [I]n contrast to *Edgar*, the [Franchise Practices Act] is applicable only to specific transactions affecting New Jersey, *i.e.*, franchises that have a "place of business" in New Jersey.
>
> Were it otherwise, nearly every aspect of substantive state law would be disabled from affecting the conduct of multi-state corporations. When New Jersey imposes a legal duty on the volitional behavior of a contracting party, that ruling will often have effects beyond state boundaries.

130 N.J. at 368-69.

The New Jersey Supreme Court also briefly analyzed the question of extraterritorial reach in terms of the due-process limitations on choice of law. *Id.* at 369. In this sense, the court stated due process requires "contacts" with the forum, "interests" of the state arising out of those contacts and "fairness" to the defendant. *Id.* (citing *Allstate Ins. Co.* v. *Hague*, 449 U.S. 302, *reh'g denied*, 450 U.S. 971 (1981)). The court then found the Franchise Practices Act satisfied this test. The court further stated:

> [T]he statute's own terms ... will allow application of the [Franchise Practices] Act only in situations in which there are "contacts" with the forum, "interests" arising out of those contacts, and "fairness to the defendant" in the sense that a defendant who acts fairly with a franchise need fear no oppressive regulation. Therefore, the [Franchise] [Practices] Act's own terms curtail any impermissible extraterritorial effect and insure its constitutionality under Commerce Clause

> or due process analysis despite some incidental extraterritorial effects.

Id. at 370-71 (citations omitted).

3. Partial Summary Judgment on the Commerce Clause Argument

In *Instructional Systems II*, the CCC motion for partial summary judgment on the Commerce Clause Argument was granted. It was determined in *Instructional Systems II*, that the Franchise Practices Act, violated the Commerce Clause. Accordingly, that portion of Count One which attempted to apply the Franchise Practices Act extraterritorially was dismissed with prejudice.

On 29 June 1993, an Order was entered amending the 2 June 1993 Order (the "Amended Order"). The Amended Order did not alter the granting of CCC's summary judgment motion or the dismissal of a portion of Count One.[24]

On 2 July 1993, ISI filed a Notice of Appeal pursuant to 28 U.S.C. § 1292(a) (the "Notice of Appeal") from the 2 June 1993 Order and the Amended Order.[25]

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[24] The Amended Order clarified that the grant of partial summary judgment on Count One affected only the extraterritorial application of the Franchise Practices Act and left standing for later resolution, that portion of Count One which sought to apply the Franchise Practices Act to the parties' relationship within the state of New Jersey.

[25] Prior to filing the Notice of Appeal, ISI moved on 16 June 1993 to certify the 2 June 1993 Order for immediate appeal to the Third Circuit pursuant to 28 U.S.C. § 1292(b). The New Jersey Attorney General, who intervened in the (continued...)

Discussion

A. Jurisdiction Pending Appeal

Section 1292(a)(1) provides that United States Courts of Appeal have jurisdiction over appeals from interlocutory orders which grant, continue, modify, refuse or dissolve injunctions. 28 U.S.C. § 1292(a). The pending ISI appeal is based on its contention that the decision in *Instructional Systems II*, which granted partial summary judgment for CCC as to Count One, denied ISI's request for injunctive relief. While the Complaint requests injunctive relief for each count, such relief was not part of the opinion in *Instructional Systems II* or part of the motion which gave rise to the opinion. Succinctly stated, that decision neither granted nor denied the injunctive relief sought in the Complaint. *See Santana Prods., Inc.* v. *Compression Polymers, Inc.*, ___ F.3d ___, No. 93-7099, slip op. at 4-6 (3d Cir. 29 Oct. 1993).[27] The Amended Order dismissed that portion of Count

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[26](...continued)
earlier summary judgment motion, also moved for immediate appeal pursuant to 28 U.S.C. § 1292(b) or, alternatively, pursuant to Fed. R. Civ. P. 54(b). Initially, in an Order filed 22 July 1993, this court found both the 1292(b) and Rule 54 requests for certification and entry of final judgment were not within its jurisdiction because of the pending section 1292(a) appeal. The Third Circuit, however, remanded the certification issue to be considered "free of ... concern as to jurisdictional restraint by reason of the interlocutory appeal." Order of the Third Circuit, dated 20 September 1993. On remand, the requests of both ISI and the New Jersey Attorney General for immediate appeal were denied. *See Instructional Systems, Inc.* v. *Computer Curriculum Corp.*, ___ F.Supp. ___ (D.N.J. 5 Oct. 1993).

[27] In *Santana Products*, the Third Circuit dismissed an appeal filed pursuant to section 1292(a)(1) because jurisdiction was lacking. There the plaintiff moved for summary judgment on only one count of its five-count complaint. The summary (continued...)

One which sought to apply the Franchise Practices Act to transactions wholly outside the state of New Jersey. The summary judgment motion presently before the court, moreover, involves claims which were not addressed in *Instructional Systems II*.

In general, once an appeal has been taken, a trial court may not "'finally adjudicate substantial rights involved in the appeal.'" *Burns* v. *County of Cambria*, 788 F.Supp. 868, 869 (W.D.Pa. 1991) (quoting *Newton* v. *Consol. Gas Co.*, 258 U.S. 165, 177 (1922)). However, when the issues before the district court are not the subject of the matter on appeal, the district court maintains jurisdiction to hear and decide those unaffected issues.

> [A]n appeal from an interlocutory order does not stay the proceedings, as it is firmly established that an appeal from an interlocutory order does not divest the trial court of jurisdiction to continue with other phases of the case

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[27](...continued)
judgment motion involved the count which sought cancellation of a trademark registration; an injunction was not sought. The order granting partial summary judgment did not include any injunctive relief. The appeal followed.

In determining that it had no jurisdiction over the appeal, the Circuit found that the order was not an injunctive order. The Third Circuit described the three-part test for determining whether an order is injunctive as follows:

> "'Orders that are directed to a party, enforceable by contempt, *and* designed to accord or protect "some or all of the substantive relief sought by a complaint" in more than a [temporary] fashion.'"

Id., slip op. at 5 (emphasis in original) (quoting *Cohen* v. *Board of Trustees of University of Medicine & Dentistry*, 867 F.2d 1455, 1465 n.9 (3d Cir. 1989) (citation omitted)). The Circuit then found that the order did not satisfy the three-part test because the order "[was] not enforceable by contempt...." Slip op. at 5-6.

Plotkin v. *Pacific Tel. & Tel. Co.*, 688 F.2d 1291, 1293 (9th Cir. 1982) (citing *Ex Parte National Enameling & Stamping Co.*, 201 U.S. 156, 162 (1906)); *see Railway Labor Executives' Ass'n* v. *Galveston*, 898 F.2d 481, 481 (5th Cir. 1990); *Britton* v. *Co-op Banking Group*, 916 F.2d 1405, 1412 (9th Cir. 1990); *New York State Org. of Women* v. *Terry*, 886 F.2d 1339, 1350 (2d Cir. 1989); *West Publishing Co.* v. *Mead Data Cent., Inc.*, 799 F.2d 1219, 1229 (8th Cir. 1986); *Taylor* v. *Sterrett*, 640 F.2d 663, 667-68 (5th Cir. 1981), *cert. denied*, 479 U.S. 1070 (1987); *United States* v. *Chicago*, 534 F.2d 708, 711 (7th Cir. 1976); *Silberman* v. *Bogle*, 486 F.Supp. 70, 72, 73 (E.D.Pa. 1980).[2/]

B. The Effect of the New Jersey State Courts' Decisions

Throughout the ISI opposition to CCC's summary judgment motion, ISI asserts this court is bound by the decision of the New Jersey Supreme Court in *N.J. Sup. Ct. Instructional Systems*. *See*, *e.g.*, ISI Opposition Brief at 10, 12-13, 15-18, 22; ISI

[2/] All but one of the cases cited by ISI to the contrary involve an appeal from a final decision. *See* ISI Opposition Brief at 8 (citing *Henry* v. *Farmer City State Bank*, 808 F.2d 1228 (7th Cir. 1986); *SEC* v. *Investors Sec. Corp.*, 560 F.2d 561 (3d Cir. 1977); *Halderman* v. *Pennhurst State Sch. and Hosp.*, 452 F.Supp. 867 (E.D.Pa. 1978), *aff'd*, 612 F.2d 131 (3d Cir. 1979)).

The one exception is *Dayton Independent School District* v. *United States Mineral Products Co.*, 906 F.2d 1059 (5th Cir. 1990), *reh'g denied*, 1990 U.S. App. LEXIS 15, 956 (5th Cir. 1990), ISI Opposition Brief at 8, and that case is distinguishable from the instant case. In *Dayton*, the Court of Appeals held that the district court lacked jurisdiction to grant the plaintiff leave to amend its complaint in such a way as to render moot the issue on appeal. The Fifth Circuit stated that the trial court did not have jurisdiction to grant the plaintiff's leave to amend the complaint because "[a] district court does not have the power to 'alter the status of the case as it rests before the Court of Appeals.'" *Id.* The current summary judgment motion involves issues which are not before the Third Circuit and, therefore, do not threaten to "alter the status" of the pending appeal.

Supplemental Brief at 13. Particularly, ISI argues preclusive effect should be given to certain statements by the New Jersey Supreme Court regarding the extraterritorial application of the Franchise Practices Act[39] and the determination that ISI is a franchise under the act. This argument is rejected.

Generally, when a Federal court is presented with claims previously adjudicated in a state court between the same parties on the same facts, the Federal court must consult state preclusion law to see what effect the state court would give to the prior action.[40] *Kremer* v. *Chemical Constr. Corp.*, 456 U.S. 461, 466 (1982); *see Parsons Steel. Inc.* v. *First Alabama Bank*, 474 U.S. 518, 523 (1986). This response is required by the Full Faith and Credit Clause of the Constitution. U.S. Const. art. IV, § 1; *see* 28 U.S.C. § 1738. Section 1738 states:

> Such Acts, records or judicial proceedings or copies thereof, so authenticated, shall have the same full faith and credit in every court within the United States and its Territories and Possessions from which they are take.

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[39] The issue of the constitutionality of the Franchise Practices Act, as the Act is sought to be applied in this case, has no bearing on the present summary judgment motion. That issue was previously litigated, and the extraterritorial application of the Franchise Practices Act was found to violate the Commerce Clause. This summary judgment motion addresses only those claims raised in the Complaint which were not decided on the previous summary judgment motion. Those claims, for the most part, involve common law principles and are not governed by the Franchise Practices Act. The only claim involved in the instant summary judgment motion which is governed by the Franchise Practices Act is the remaining portion of Count One seeking in-state application of the statute.

[40] Declaratory judgments are included in the category of decisions to be given preclusive effect. *See Washington* v. *Gould*, 39 N.J. 527, 533 (1963). Otherwise, they would be barred as being advisory opinions. *Friedland* v. *State*, 149 N.J.Super. 483 (Law Div. 1977).

18 U.S.C. § 1738. Accordingly, a state court decision is to be given the same preclusive effect by the Federal court as it would be given under state law. *See Migra* v. *Warren City Sch. Dist. Bd. of Educ.*, 465 U.S. 75, 81 (1984); *Bernardsville Quarry* v. *Bernardsville*, 929 F.2d 927, 929-30 (3d Cir.), *cert. denied*, ___ U.S. ___, 112 S.Ct. 182 (1991).

In the area of abstention,[41/] however, normal principles of

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[41/] Abstention is a doctrine by which a Federal court may refrain from hearing state law issues before the state courts have had the opportunity to resolve those issues authoritatively. *See Pullman Co.*, 312 U.S. 496.

> The doctrine [of abstention] is ... a means devised to ameliorate some of the problems inevitably growing out of our unique federalism. For [F]ederal question cases, unseemly or unnecessary collision with a state is to be avoided, or at least postponed until such time as it is inescapable. Although the adjustment between the National Courts and a State takes a different turn in diversity cases, the underlying problem is essentially the same. And the impact—on local litigants and jurisprudence—is equally, if not more, awesome.

United Servs. Life Ins. Co. v. *Delaney*, 328 F.2d 483, 485-86 (5th Cir. 1964) (Brown, J. concurring) (footnotes omitted), *cert. denied sub nom.*, *Paul Revere Life Ins. Co.* v. *First Nat'l Bank*, 377 U.S. 935 (1964), *reh'g denied*, 377 U.S. 973 (1964); *see Grodes* v. *Mutual Fire, Marine & Inland Ins. Co.*, Nos. 93-1128 and 93-1129, slip op. at 4-5 (3d Cir. 21 Oct. 1993). The "'classic' case for application of the *Pullman* doctrine involves a constitutional attack on a state statute under circumstances where one possible construction of the statute would avoid or substantially alter the constitutional issue." *Frederick L.* v. *Thomas*, 578 F.2d 513, 516 (3d Cir. 1978); *see Grodes*, slip op. at 4.

Under *Pullman* abstention, the district court does not dismiss the case; "abstention 'does not ... involve the abdication of [F]ederal jurisdiction, but only the postponement of its exercise.'" *England* v. *Louisiana State Bd. of Medical Examiners*, 375 U.S. 411, 416 (1964) (quoting *Harrison* v. *NAACP*, 360 U.S. 167, 177 (1959)). Accordingly, the proper procedure upon abstention is for the

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preclusion are modified. In particular, when a Federal court has abstained from hearing an issue which is to be determined under state law but has reserved certain other issues, a state court decision has preclusive effect only as to those issues properly before it. "Thus in cases where, but for the application of the abstention doctrine, the primary fact determination would have been by the District Court, a litigant may not be unwillingly deprived of that determination." *England*, 375 U.S. at 417 & n.8;[42] *NAACP* v. *Button*, 371 U.S. 415, 427 (1963) (litigants have a right to return to Federal court after abstention); *Ivy Club*, 943 F.2d at 283 (when litigant reserves right to return to Federal court, "preclusion applies only to the state law question decided by the state court"); *Bradley*, 913 F.2d at 1071 (litigant may reserve right to have issues decided in Federal court); *Kovats*, 749 F.2d at 1047 (same); *see also Peduto*, 878 F.2d at 729 n.5.

This exception to the general principles of preclusion was articulated by the Supreme Court in *England*. In that case, plaintiff chiropractors initially sued in Federal court seeking both an

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[41](...continued)
district court to retain jurisdiction so as to be able to consider any remaining Federal issues at the end of the state courts' determination. *See Deakins* v. *Monaghan*, 484 U.S. 193, 197-98 (1988); *Allen* v. *McCurry*, 449 U.S. 90, 101 n.17 (1980); *Ivy Club* v. *Edwards*, 943 F.2d 270, 279 (3d Cir. 1991), *cert. denied sub nom.*, *Del Tufo* v. *Ivy Club*, ___ U.S. ___, 112 S.Ct. 1282 (1992); *Georevich* v. *Strauss*, 772 F.2d 1078, 1094 n.21 (3d Cir. 1985), *cert. denied*, 475 U.S. 1028 (1986).

[42] The holding in *England* remains valid. In *Bradley* v. *Pittsburgh Bd. of Educ.*, 913 F.2d 1064 (3d Cir. 1990), the Third Circuit stated that its "precedent demonstrates the continued vitality of the rule enunciated in *England*." *Id.* at 1071 (citing *Kovats* v. *Rutgers*, 749 F.2d 1041, 1046 (3d Cir. 1984); *New Jersey Educ. Ass'n* v. *Burke*, 579 F.2d 764, 772-74 (3d Cir.), *cert. denied*, 439 U.S. 894 (1978); *Peduto* v. *North Wildwood*, 878 F.2d 725, 729 n.5 (3d Cir. 1989)); *see Ivy Club*, 943 F.2d at 283; *Bernardsville Quarry*, 929 F.2d at 929.

interpretation of a state statute regulating medical licenses, and, if the statute were found to apply to them, a ruling on its constitutionality. The district court abstained and remanded the plaintiffs to state court for a determination of the state law issues. After litigating and losing both their state and Federal claims in the state courts, the plaintiffs attempted to return to the district court. The district court dismissed the plaintiffs' attempted return on the ground that their proper remedy was to appeal to the United States Supreme Court. The dismissal was upheld by the Court of Appeals; the plaintiffs sought review in the Supreme Court.

Overturning the courts below, the Supreme Court held that

> in cases where, but for the application of the abstention doctrine, the primary fact determination would have been by the District Court, a litigant may not be deprived of that determination ... he may inform the state courts that he is exposing his [F]ederal claims there only for the purpose of complying with *Windsor*,[4] and that he intends, should the

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[4] In *Government Civic Org. Employees Comm.* v. *Windsor*, 353 U.S. 364 (1957), the plaintiff labor union sued in Federal court seeking to enjoin the enforcement of a state statute it argued was unconstitutional. The district court abstained from ruling on the issue of the statute's constitutionality in order to allow the state courts to determine whether the plaintiff constituted a labor union within the meaning of the statute. The plaintiff accordingly sought a ruling from the state court as to whether the statute was applicable to it but never raised the constitutional issues. The plaintiff feared that by raising the constitutional issues the state court could address those issues with preclusive effect. The state's highest court held that the statute was applicable, and the plaintiff returned to the district court for a determination of the constitutional question. The district court dismissed the case reasoning that it was inappropriate for it to determine the constitutional validity of the statute because the state court determination was incomplete; the state court determination had not been undertaken in light of the constitutional challenges. On appeal, the United States Supreme Court remanded

(continued...)

> state court hold against him on the question of state law, to return to the District Court for disposition of his [F]ederal contentions.

England, 375 U.S. at 421.

If this modification of the general principles of preclusion and Full Faith and Credit did not exist, *Pullman* abstention would create "a roundabout way for [the district court] to decline plaintiff's proper invocation of [F]ederal jurisdiction." *Navedo* v. *Acevedo*, 752 F.Supp. 523, 533 (D.P.R. 1990), *aff'd sub nom.*, *Granados Navedo* v. *Acevedo*, 932 F.2d 294 (1st Cir. 1991). The *England* rule is necessary because otherwise, in cases where the jurisdiction of the district court is properly invoked, the application of abstention would serve to deny a litigant his guaranteed Federal forum. This result would conflict with the duty imposed by Congress on the Federal judiciary with respect to the litigant's appropriate choice of forum. *See Zwickler* v. *Koota*, 389 U.S. 241, 248 (1967). As the Supreme Court stated in *England*:

> There are fundamental objections to any conclusion that a litigant who has properly invoked the jurisdiction of a Federal District Court to consider [F]ederal constitutional claims can be compelled, without his consent and through no fault of his own, to accept instead a state court's determination of those claims. Such a result would be at war with the unqualified terms in which Congress, pursuant to constitutional authorization, has conferred specific categories of jurisdiction upon the [F]ederal courts, and with the

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[2](...continued)
the case to the district court and ordered it to retain jurisdiction while the plaintiff returned to the state courts for a proper determination of the state issues in light of the constitutional challenges. *Id.* at 839.

> principle that "When a Federal court is properly appealed to in a case over which it has by law jurisdiction, it is its duty to take such jurisdiction...." The right of a party plaintiff to choose a Federal court where there is a choice cannot be properly denied.

England, 375 U.S. at 415 (citation omitted).

> Indeed, any argument
>
> that the state court proceeding bars ... inquiry [by the district court] ignores the very concept of *Pullman* abstention which entails a [F]ederal court taking jurisdiction, staying the [F]ederal suit while the parties clarify the state issues in state court, and then restoring the action for the adjudication of [F]ederal claims if the need for such resolution survives the state judicial procedure.

Navedo, 752 F.Supp. at 533; *see England*, 375 U.S. at 417.

In the absence of a waiver, all issues reserved by the litigant for determination upon his return to Federal court, including factual issues, may be litigated in Federal court. The Supreme Court in *England* stated that the need for the reservation of issues

> is especially true as to issues of fact. Limiting the litigant to review here [the Supreme Court] would deny him the benefit of a [F]ederal trial court's role in constructing a record and making factual findings. How the facts are found will often dictate the decision of [F]ederal claims.

375 U.S. at 416. Accordingly, if factual issues necessary to the determination of the reserved issues are decided by the state courts,

such issues may be relitigated upon return to the Federal court. *See id.*

> Upon return to [F]ederal court, the [F]ederal plaintiff may fully litigate his [F]ederal claims, including the factual issues that may be identical to those underlying the state law question.

Ivy Club, 943 F.2d at 283.

The option of reserving issues for adjudication in Federal courts is available to both plaintiffs and defendants.

> The reservation may be made by any party to the litigation. Usually the plaintiff will have made the original choice to litigate in the [F]ederal court, but the defendant also, by virtue of the removal jurisdiction, 28 U.S.C. § 1441(b), has a right to litigate the [F]ederal question there. Once an issue has been joined in the [F]ederal court, no party is entitled to insist, over another's objection, upon a binding state court determination of the [F]ederal question.

England, 375 U.S. at 422 n.13.

It also appears that litigants who remove actions to Federal court based on diversity jurisdiction are equally entitled to return to the Federal forum after that court's exercise of abstention. *See* 17A Charles Allen Wright, Arthur R. Miller & Edward H. Cooper, *Federal Practice and Procedure* § 4243 at 77 n.34 ("[r]eading the footnote [*England*, 375 U.S. at 422 n.13] as a whole, it seems clear that the Court did indeed mean that a defendant may *always* make such a reservation") (emphasis added). Accordingly, even state law issues which were properly raised in

the Federal court pursuant to diversity jurisdiction may be reserved for Federal adjudication.

In the instant case, the matter, which was originally filed in state court, was removed to this court on 6 February 1989 based on the presence of diversity jurisdiction.[4] The New Jersey state courts subsequently lost all jurisdiction over this matter upon removal. "[A]fter removal, the jurisdiction of the state court absolutely ceases." *Maseda* v. *Honda Motor Co.*, 861 F.2d 1248, 1254 (11th Cir. 1988); *see Resolution Trust Corp.* v. *Murray*, 935 F.2d 89, 92-93 (5th Cir. 1991); *Chesimard* v. *Kuhlthau*, 370 F.Supp. 473, 475 (D.N.J. 1974); 28 U.S.C. § 1446(d) ("the State shall proceed no further unless and until the case is remanded"). CCC's removal of the case to this court, moreover, established its right to have the dispute resolved in Federal court. *See England*, 375 U.S. at 422 n.13.

The way in which ISI sought to have the Franchise Practices Act applied raised the question of whether the statute violated the Commerce Clause. Preliminary to the constitutional issue, however, was the question of whether the Franchise Practices Act could be applied to the relationship between ISI and CCC. In the absence of any clear guidance from the New Jersey case law or the

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[4] The procedure of removal gives a defendant who has been sued in a state court of competent jurisdiction the right to substitute a Federal forum for that initially selected by the plaintiff. The removal statute arose out of the same fear of local prejudices which led to diversity jurisdiction.

> [T]he very object of giving to the national courts jurisdiction ... in controversies between citizens of different states was to institute independent tribunals which ... would be unaffected by local prejudices and sectional views....

Burgess v. *Seligman*, 107 U.S. 20, 34 (1883).

legislative history of the Franchise Practices Act, the motion for abstention was granted to "afford[] the courts of New Jersey a fair opportunity to provide a definitive interpretation of the Franchise Practices Act." *Instructional Systems I*, slip op. at 13.

As mentioned, the following issues were remanded to the New Jersey state courts: (1) Whether the Franchise Practices Act has extraterritorial reach beyond the State of New Jersey and, if so, to what extent, (2) whether there is a "community of interest" between ISI and CCC and (3) whether ISI has a "place of business" within the meaning of the Franchise Practices Act. Remand Order at 1; 28 July 1989 Tr. at 4. Excluded from the Remand Order were issues concerning any constitutional challenge to the Franchise Practices Act.[4/] Remand Order at 2. This court also retained jurisdiction over all other issues which were not remanded including "the application of the principles of law determined by the state court to the facts of this case" and Counts Two through Seven. Remand Order at 2.

By virtue of its right to have the dispute litigated in Federal court, CCC had a corresponding right to return to Federal court after abstention to have the issues it reserved heard. *See England*, 375 U.S. at 422 n.13 ("the defendant ... by virtue of the removal jurisdiction, 28 U.S.C. § 1441(b), has a right to litigate" in Federal court). Upon abstention that right would be involuntarily lost to CCC if it were not allowed the option of returning to this court for Federal adjudication of the issues which it reserved and from which this court did not abstain.

[4/] ISI conceded CCC properly reserved its right to a determination of the Commerce Clause Argument by a Federal Court. *See* Letter from ISI, addressed to the court, dated 11 November 1992 (the "ISI 11 Nov. 1992 Letter"), at 2. There is no indication in the record that CCC subsequently waived its right to a Federal adjudication of the Commerce Clause Argument.

State courts may not ignore the fact that a Federal court remanded only a limited scope and number of issues and reserved jurisdiction to itself for the remainder. The Third Circuit has cautioned that Federal courts must be particularly careful not to deprive litigants of their right to a Federal adjudication of reserved issues where the state court has "resolve[d] issues beyond those which the [F]ederal court abstained." *Kovats*, 749 F.2d at 1047. The proper method of dealing with a state court decision which goes beyond the boundaries of the remand order is to limit the preclusive effect given to the state court determination. *See England*, 375 U.S. at 415; *Kovats*, 749 F.2d at 1047; *see also Navedo*, 752 F.Supp. at 533.

It appears CCC took the proper steps to reserve its right to have determined in Federal court the question of the constitutional validity of the Franchise Practices Act under the Commerce Clause as well as the application of the statute to its relationship with ISI. *See* CCC Ch.Div. Brief, at 1470a-71a. CCC's right to have the reserved issues adjudicated by a Federal court could only be waived by it; there is no indication in the record that CCC waived its right to a Federal adjudication of the reserved issues in this case. Accordingly, to the extent the New Jersey state courts went beyond the boundaries of the Remand Order, as modified, and decided issues reserved for adjudication in Federal court, such decisions are not entitled to preclusive effect in this court.

C. Summary Judgment Standard of Review

To prevail on a motion for summary judgment, the moving party must establish "there is no genuine issue as to any material fact and that [it] is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c). The present task is to determine whether disputed issues of fact exist, but a district court may not resolve factual disputes in a motion for summary judgment. *Anderson* v. *Liberty*

Lobby Inc., 477 U.S. 242, 249-50 (1986); *see also Desvi, Inc.* v. *Continental Ins. Co.*, 968 F.2d 307, 308 (3d Cir. 1992) ("threshold inquiry is whether there are 'genuine factual issues that properly can be resolved only by a finder of fact because they may reasonably be resolved in favor of either party'") (citations omitted); *Gray* v. *York Newspapers, Inc.*, 957 F.2d 1070, 1078 (3d Cir. 1992) ("We apply the test ... (1) Is there no genuine issue of material fact and (2) is one party entitled to judgment as a matter of law?") (quotations omitted); *Hackman* v. *Valley Fair*, 932 F.2d 239, 241 (3d Cir. 1991) ("summary judgment is inappropriate when a conflict of a material fact is present in the record"); *Nathanson* v. *Medical College of Pa.*, 926 F.2d 1368, 1380 (3d Cir. 1991) (summary judgment may not be granted "if there is a disagreement over what inferences can be reasonably drawn from the facts even if the facts are undisputed").

All evidence submitted must be viewed in a light most favorable to the party opposing the motion. *Matsushita Elec. Indus. Co.* v. *Zenith Radio Corp.*, 475 U.S. 574, 587 (1986); *Williams* v. *New Castle County*, 970 F.2d 1260, 1264 (3d Cir. 1992); *Boyle* v. *Governor's Veterans Outreach & Assistance Center*, 925 F.2d 71, 75 (3d Cir. 1991); *Weldon* v. *Kraft, Inc.*, 896 F.2d 793, 797 (3d Cir. 1990); *Todaro* v. *Bowman*, 872 F.2d 43, 46 (3d Cir. 1989). "Any 'unexplained gaps' in materials submitted by the moving party, if pertinent to material issues of fact, justify denial of a motion for summary judgment." *Ingersoll-Rand Fin. Corp.* v. *Anderson*, 921 F.2d 497, 502 (3d Cir. 1990) (quoting *O'Donnell* v. *United States*, 891 F.2d 1079, 1082 (3d Cir. 1989)).

Although the summary judgment hurdle is a difficult one to overcome, it is by no means insurmountable. As the Supreme Court has stated, once the party seeking summary judgment has

pointed out to the court the absence of a genuine issue of material fact,

> its opponent must do more than simply show that there is some metaphysical doubt as to the material facts. In the language of the Rule, the nonmoving party must come forward with "*specific facts* showing that there is a *genuine issue for trial*." Where the record taken as a whole could not lead a rational trier of fact to find for the non-moving party, there is no "genuine issue for trial."

Matsushita, 475 U.S. at 586-87 (emphasis in original, citations and footnotes omitted). In other words, the inquiry involves determining "'whether the evidence presents a sufficient disagreement to require submission to a jury or whether it is so one-sided that one party must prevail as a matter of law.'" *Brown* v. *Grabowski*, 922 F.2d 1097, 1111 (3d Cir. 1990) (quoting *Anderson*, 477 U.S. at 251-52), *cert. denied sub nom.*, *Roselle* v. *Brown*, 111 S.Ct. 2827 (1991); *see also Gray*, 957 F.2d at 1078 ("there is no issue for trial unless there is sufficient evidence favoring the nonmoving party for a jury to return a verdict for that party").

The Supreme Court elaborated on the summary judgment standard in *Anderson*: "If the evidence [submitted by a party opposing summary judgment] is merely colorable, or is not significantly probative, summary judgment may be granted." 477 U.S. at 249-50 (citations omitted). The Supreme Court went on to note in *Celotex Corp.* v. *Catrett*, 477 U.S. 317 (1986): "One of the principal purposes of the summary judgment rule is to isolate and dispose of factually unsupported claims or defenses, and we think it should be interpreted in a way that allows it to accomplish this purpose." *Id.* at 323-24 (footnote omitted); *see also Carlson* v. *Arnot-Ogden Memorial Hosp.*, 918 F.2d 411, 413 (3d Cir.

1990) ("nonmoving party must adduce more than a mere scintilla of evidence in its favor"); *Maguire* v. *Hughes Aircraft Corp.*, 912 F.2d 67, 72 (3d Cir. 1990) (non-moving party may not rest upon mere allegations); *Schoch* v. *First Fidelity Bancorporation*, 912 F.2d 654, 657 (3d Cir. 1990) (neither unsupported allegations in pleadings and memoranda of law nor conclusory allegations in affidavits will establish genuine issue of material fact); *Hozier* v. *Midwest Fasteners, Inc.*, 908 F.2d 1155, 1165 (3d Cir. 1990) (cannot create issue of fact merely by questioning credibility of movant's witnesses; circumstantial evidence may raise issue of fact); *Aronow Roofing Co.* v. *Gilbane Bldg. Co.*, 902 F.2d 1127, 1128 (3d Cir. 1990) ("summary judgment will be granted where the non-moving party fails to 'establish the existence' of an element essential to the case").

D. Summary Judgment as to the Remainder of Count One[46]

1. Failure to Renew the 1984 Agreement

Section 10-5 of the Franchise Practices Act, N.J.S.A. § 56:10-5, sets forth exacting requirements for the termination of a franchise defined under the act. Section 10-5 provides in pertinent part:

> It shall be a violation of this act for any franchisor directly or indirectly through any officer, agent, or employee to terminate, cancel or fail to renew a franchise without having first given written notice setting forth all the reasons for such termination, cancellation, or intent not to renew to the

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[46] For purposes of this discussion, it is assumed ISI is a franchise within the meaning of the Franchise Practices Act to the extent of the act's application within the state of New Jersey.

> franchisee at least 60 days in advance of such termination, cancellation, or failure to renew.... It shall [also] be a violation of this act for a franchisor to terminate, cancel or fail to renew a franchise without good cause. For the purposes of this act, good cause for terminating, canceling, or failing to renew a franchise shall be limited to failure by the franchisee to substantially comply with those requirements imposed upon him by the franchise.

N.J.S.A. § 56:10-5. As the Third Circuit has stated, this section of the Franchise Practices Act creates "an exception to the general rule that two businesses are free to terminate their business relationship according to the terms of their contract." *New Jersey Am., Inc.* v. *Allied Corp.*, 875 F.2d 58, 61 (3d Cir. 1989).

ISI argues that the refusal of CCC in 1989 to renew each term of the 1984 Agreement constitutes a constructive non-renewal in violation of the Franchise Practices Act. ISI Opposition Brief at 31-32. It is undisputed that the 1989 Agreement continued the exclusive distributorship for ISI in New Jersey. ISI contends, however, the continuation of the parties' relationship in New Jersey through the 1989 Agreement does not immunize CCC from liability under the Franchise Practices Act. ISI Opposition Brief at 32.

ISI cites the following modifications imposed by the 1989 Agreement, as constituting constructive termination: the reduction of the Marketing Territory,[47] the requirement of a personal guaranty from Kaminer, the restrictions on Kaminer's permitted

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[47] The elimination of the Eight States from the Marketing Territory cannot be interpreted as a violation of the Franchise Practices Act. *Instructional Systems II* held the application of the Franchise Practices Act outside of New Jersey violates the Commerce Clause.

activities and the elimination of ISI's "most favored nation rights" in all present and future pricing. ISI Opposition Brief at 34 & n.9.

ISI's argument that there has been a constructive non-renewal is not persuasive because its exclusive distributorship of CCC products continues in New Jersey, the only state governed by the Franchise Practices Act. *See Wisconsin Music Network, Inc.* v. *Musak Ltd. Partnership*, 822 F.Supp. 1332, 1336 (E.D.Wis. 1992) ("the proposition that the offer of a new contract with different terms amount to a termination ... 'is nonsense'"), *aff'd*, 1993 U.S. App. LEXIS 23,742 (7th Cir. 1993).

If ISI had refused to sign the 1989 Agreement on the basis that the new provisions were unreasonable and unbearable, thereby terminating its distributorship in New Jersey, it may well have been in a position to argue there had been a constructive non-renewal. *See Carlo C. Gelardi Corp.* v. *Miller Brewing Co.*, 502 F.Supp. 637, 652-53 (D.N.J. 1980) (addressing question of whether franchisor's actions had "forced" franchisee to quit distributorship in violation of section 10-5). In addition, if CCC had terminated or attempted to terminate ISI's distributorship in New Jersey based on ISI's failure to comply with an unreasonable provision added by the 1989 Agreement, ISI may well have been in a position to challenge such action as a violation of section 10-5.

Until there has been a termination or at least threatened termination of ISI's distributorship in New Jersey, there is no basis for finding a violation of section 10-5. ISI's recourse for any unreasonable standards allegedly imposed by the 1989 Agreement is resort to section 10-7(e) which prohibits unreasonable standards of performance, otherwise section 10-7(e) would be rendered superfluous.

Because there is no genuine issue of material fact, summary judgment is appropriate as to that portion of Count One which alleges a violation of section 10-5.

2. Unreasonable Standards of Performance

ISI argues that certain changes imposed by the 1989 Agreement constitutes "unreasonable standards of performance" in violation of section 10-7 of the Franchise Practices Act. ISI Opposition Brief at 35; Complaint, ¶ 42. Section 10-7 provides in pertinent part:

> It shall be a violation of th[e Franchise Practices] Act for any franchisor, directly or indirectly, through any officer, agent or employee, to engage in any of the following practices:
> ...
> (e) To impose unreasonable standards of performance upon a franchisee.

N.J.S.A. § 56:10-7(e).

ISI states that the new sales and discount quotas in the 1989 Agreement, "when combined with ISI's loss of territory and loss of exclusivity in marketing hardware and software, were not reasonable." ISI Opposition Brief at 36-37. As support ISI refers to the certification of its expert, Peter Max, *id.* at 37, which states:

> The future sales and discount quotas CCC has set for ISI do not adequately reflect either these changes in territory [the limitation of the Marketing Territory to the Three State Marketing Territory] or other material changes in the manner in which ISI is allowed to compete and in the competitive environment. Under the terms of the proposed contract, ISI

> is severely limited in its ability to penetrate further those markets it retains.

Certification of Peter Max, dated 13 July 1989, attached as Exhibit C to the Eakeley Certif. (the "Max Certif."), at ¶ 18.

CCC argues, however, that the 1989 Agreement did not impose any unreasonable standards on the performance of ISI. CCC Moving Brief at 13. In support of that argument, CCC states that ISI met the discount and termination quotas for 1989 and 1990. *Id.* ISI does not dispute this but argues that the fact it was able to meet the quotas is not an accurate indication of the reasonableness of those quotas because it had to struggle to meet them. ISI Opposition Brief at 37.

Whether the changes imposed by the 1989 Agreement, including the elimination of the Eight States, were reasonable under section 10-7(e) is a fact intensive issue. When all factual inferences are drawn in favor of ISI, it cannot be said that there are no genuine issues of material fact as to whether the changes were reasonable under section 10-7(e). Contrary to the CCC argument that ISI has submitted only conclusory statements in opposition to its argument that the terms of the 1989 Agreement were reasonable, ISI has submitted an expert affidavit of the unreasonableness of the changes. *See* Max Certif. The affidavit raises genuine issues of material fact which preclude summary judgment on the portion of Count One which alleges a violation of section 10-7(e).

E. Summary Judgment as to the Common Law Causes of Action

This summary judgment motion also involves the remaining counts in the Complaint—Counts Two through Seven—which

concern allegations of breach of contract, breach of implied covenant of good faith and fair dealing, tortious interference with prospective economic relationships, unfair competition, unjust enrichment and breach of fiduciary duty.

1. Choice of Law Question

Generally, in a diversity action a Federal court is obliged to apply the substantive law of the state in which the forum is located. *Klaxon Co.* v. *Stentor Elec. Mfg. Co.*, 313 U.S. 487, 496 (1941); *Lacey* v. *Cessna Aircraft Co.*, 932 F.2d 170, 187 (3d Cir.), *reh'g denied en banc*, 1991 U.S. App. LEXIS 22,458 (3d Cir. 1991); *Shuder* v. *McDonald's Corp.*, 859 F.2d 266, 269 (3d Cir. 1988); *Pancza* v. *Remco Baby, Inc.*, 761 F.Supp. 1164, 1168 (D.N.J. 1991); *Hoffman Equip., Inc.* v. *Clark Equip. Co.*, 750 F.Supp. 1222, 1229 (D.N.J. 1990), *aff'd mem.*, 935 F.2d 1281 (3d Cir. 1991).

In contractual disputes, New Jersey follows the Restatement (Second) of Conflict of Laws § 188 (1971) (the "Restatement") to determine which state's law governs. *State Farm Mut. Auto. Ins. Co.* v. *Estate of Simmons*, 84 N.J. 28, 34 (1980); *Pancza*, 761 F.Supp. at 1168. The Restatement standard, known as the "most significant relationship" test focuses on the state which has the most significant connections with the transaction and the parties.[4] *Pancza*, 761 F.Supp. at 1168; *see Rohm & Haas Co.*, 689 F.2d at 429. Under the Restatement approach, factors involved in the significant relationship test (the domicile of the parties, the place of contracting, the place of performance and the location of the subject matter) are balanced against the reasonable expectations

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[4] The same test is used for tort cases. *See Rose* v. *Port of N.Y. Auth.*, 61 N.J. 129, 139-40 (1972); *Rohm & Haas Co.* v. *Adco Chem. Co.*, 689 F.2d 424, 429 (3d Cir. 1982).

of the contracting parties and the governmental and legislative interests of each interested state. *State Farm*, 84 N.J. at 34; *Pancza*, 761 F.Supp. at 1168.

This is predominantly a breach of contract case. The contract at issue included a choice of law provision which requires that the legal relations created by the contract be governed by the laws of California. 1984 Agreement, § 14.10. Ordinarily, when the parties to a contract have agreed to be governed by the laws of a particular state, New Jersey courts have upheld the contractual choice-of-law provision as long as that provision does not violate New Jersey's public policy. *See Winer Motors, Inc.* v. *Jaguar Rover Triumph, Inc.*, 208 N.J.Super 666, 671-72 (App.Div. 1986); *Kalman Floor Co.* v. *Joseph L. Muscarelle, Inc.*, 196 N.J.Super. 16, 21-22 (App.Div. 1984), *aff'd*, 98 N.J. 266 (1985).

ISI argues, however, that New Jersey rather than California law applies because (1) New Jersey has the most significant interest in the dispute and (2) the New Jersey state courts have previously determined New Jersey law should apply. ISI Opposition Brief at 10-13. With respect to the latter contention, ISI overlooks the fact that the New Jersey state courts' choice of law discussions concerned only Count One and centered on the involvement of the Franchise Practices Act. Specifically, the New Jersey Supreme Court reasoned:

> Despite some contrary precedent, "[m]ost courts *** have held that the parties to a franchise agreement cannot avoid the franchise law of the state in which the franchisee is located by providing in their agreement that the laws of another state will govern."

N.J. Sup.Ct. Instructional Systems, 130 N.J. at 344 (citation omitted); *see also App.Div. Instructional Systems*, 243 N.J.Super. at 57-58; Ch.Div. Tr. at 7-20, 73-74.

The analysis of the state courts as to the choice of law issue has no relevance with regard to Counts Two through Seven. The state courts dealt only with limited issues rising exclusively from Count One. Counts Two through Seven were not remanded.[22] The state courts' reasoning focused solely on the application of the

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[22] In fact, it was explicitly stated that Counts Two through Seven were *not* remanded to the state courts pursuant to the abstention doctrine.

> THE COURT: First, I want to indicate that I do not view it as an application to remand the entire case. I view it as an application to remand certain of the issues. I'm inclined to grant the remand on the issues of the [extraterritorial] application ... to states beyond New Jersey.
>
> As well, in light of the comments of Judge Becker [in *New Jersey Am.*,] with regard to the almost total absence of instruction from the New Jersey courts and absence of legislative history, with regard to what I consider to be coupled issues of community of interest, place of business, licensee.
>
> These are the issues that were raised by [CCC]. It would not be my intent and, obviously, [CCC] has the ability, which I assume they will exercise, to reserve the [F]ederal issue for my determination at a later point, if that's necessary. The [F]ederal issue being whether there is a commerce clause implication here which would result in a declaration that as applied to these facts the Franchise Practices Act would be unconstitutional.
>
> It would also be my inclination to stay the remainder of the [C]omplaint, [C]ount [T]wo through [S]even, for later determination in this court.

Transcript of Proceedings, 20 July 1989 (the "20 July 1989 Transcript"), at 2-3. The Remand Order administratively stayed the issues arising from Counts Two through Seven pending determination of the remanded issues.

Franchise Practices Act. The state court analysis has no relevance in the context of the Common Law Counts.

CCC does not object, however, to the application of New Jersey law. It contends the outcome is the same under the application of the laws of either New Jersey or California. CCC Moving Brief at 6 n.8. Accordingly, for purposes of this summary Judgment motion, New Jersey law will be applied.[20]

2. Preemption

ISI repeatedly refers to the Franchise Practices Act as support for its common law causes of action. In particular, it points to various aspects of the holding in *N.J. Sup. Ct. Instructional Systems*. *See, e.g.*, ISI Opposition Brief at 7, 10-11, 14-18, 22, 25. This ISI argument inappropriately confuses ISI's claim in Count One with the claims it asserts in Counts Two through Seven.

Count One is mutually exclusive to Counts Two through Seven. If ISI were a franchisee and the Franchise Practices Act had extraterritorial application, the entire Complaint would be governed by the Franchise Practices Act. In that event, the Common Law Counts are entirely preempted and ISI would be permitted to proceed only for violations of the Franchise Practices Act. *Horn* v. *Mazda Motor of Am., Inc.*, 265 N.J.Super. 47, 53 n.2 (App.Div.) ("[a]ny common law causes of action were preempted by the Franchise Practices Act"), *certif. denied*, ___ N.J. ___ (1993); *Tynan* v. *General Motors Corp.*, 248 N.J.Super. 654, 670

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[20] When examination of the two possible choices of state law reveals that the outcome would be the same under either, "New Jersey conflicts of law rules permit the resolution of the case without a choice between the laws of the two states." *Rohm*, 689 F.2d at 429; *see Pfau* v. *Trent Aluminum Co.*, 55 N.J. 511, 527 (1970).

(App.Div. 1991) ("We recognize that the statute does not expressly provide that all common law actions stemming from the improper withholding of consent to transfer are subsumed within or preempted by the [Franchise Practices] Act. Nevertheless, we reject the contention that a common law tort survives."), *certif. denied in part rev'd in part on other grounds*, 127 N.J. 269 (1992); *see Freedman Truck Ctr., Inc.* v. *General Motors Corp.*, 784 F.Supp. 167, 178 (D.N.J. 1992) ("[T]he court finds neither mandate nor warrant for adding to the formidable protections the legislature has already afforded franchisees. Accordingly, the court will grant defendant's motion to dismiss plaintiff's claim based on alleged violations of New Jersey common law and public policy.").

If ISI is not a franchisee under the Franchise Practices Act, the act will not apply, and Count One will be dismissed. Under that scenario, Counts Two through Seven survive and the allegations in the Complaint are governed by common law principles. *Dunkin' Donuts of Am., Inc.* v. *Middletown Donut Corp.*, 100 N.J. 166, 176 (1985) (common law principles of freedom of contract applicable to franchise agreements outside the Franchise Practices Act); *cf. Elizarraras* v. *Bank of El Paso*, 631 F.2d 366, 376 (5th Cir. 1980) ("[w]here the U.C.C. does not address an issue, one should refer to the common law for guidance").

If ISI is a franchisee under the Franchise Practices Act and there is no extraterritorial application of the Franchise Practices Act, Count One, to the extent it relates to the parties' relationship in New Jersey, will be governed by the act. In such a scenario, Counts Two through Seven will survive to the extent they relate to the parties relationship outside of New Jersey. Accordingly, the following discussion as to the merits of the Common Law Counts is undertaken. *See Dunkin' Donuts*, 100 N.J. at 176.

3. Count Two—Breach of Contract

ISI alleges CCC breached the 1984 Agreement by its refusal to renew the exact terms of the agreement in 1989.[5]/ Complaint, ¶ 46. ISI's breach of contract claim is based on the argument that the Termination Provision in the 1984 Agreement is unenforceable. ISI contends CCC, therefore, breached the contract by allowing the 1984 Agreement to terminate and by entering into a new contract with different terms in 1989. ISI argues that the Termination Provision is unenforceable for essentially two reasons: (1) the Termination Provision did not effect the alleged understanding between the parties that the relationship would continue unchanged unless CCC had good cause to change it and (2) the Termination Provision was unconscionable and violated public policy. ISI Opposition Brief at 5-6, 15-18.

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[5]/ ISI also alleges in the Complaint that CCC breached the 1984 Agreement by its "refusal to provide ISI with necessary technical information with respect to the IBM-CCC hardware program." Complaint, ¶ 46. The Complaint states:

> CCC has refused to provide ISI with any necessary technical, pricing and discount information with respect to the new IBM CCC hardware program now being offered, effective January 27, 1989 for sale along with other CCC [p]roducts thereby interfering with and significantly impeding ISI's efforts to market and sell CCC [p]roducts.

Id., ¶ 40. The referenced arrangement between CCC and IBM, however, apparently did not take place until sometime well after the filing of the Complaint. *See* Excerpts from the Deposition of Suppes (the "Suppes Dep."), attached as Exhibit D to the Rosdeitcher Aff., at 12-13. As of June 1989, the arrangement was still in the negotiations' phase. *Id.* As well, ISI is silent on this issue in its Opposition Brief. It appears, therefore, this issue has been abandoned.

Under New Jersey law, the general rule governing contract disputes is:

> Basic to our free enterprise system is the right to enter or to refrain from entering or continuing a contractual relationship. Rejection of an offer, or termination of a contract in accordance with its express terms, is a right the exercise of which is unencumbered by the threat of tort liability.

Rothermel v. *International Paper Co.*, 163 N.J.Super. 235, 244 (App.Div. 1978), *certif. denied*, 79 N.J. 487 (1979); *see Dunkin' Donuts*, 100 N.J. at 176 (common law principles of freedom of contract applicable to franchise agreements outside the Franchise Practices Act); *N.J. Sup. Ct. Instructional Systems*, 130 N.J. at 339 ("[a]t common law, freedom of contract was the rule applicable to franchise agreements"); *New Jersey Am.*, 875 F.2d at 61 (the "general rule that two businesses are free to terminate their business relationship according to the terms of their contract").

a. The Termination Provision

The appropriateness of granting summary judgment on Count Two in favor of CCC depends upon whether the contract terms at issue are clear and unambiguous. *Ingersoll-Rand*, 921 F.2d at 502; *see Cury* v. *Colonial Life Ins. Co.*, 737 F.Supp. 847, 853 (E.D.Pa. 1990). The question whether a term is clear or ambiguous is a question of law. *Tigg Corp.* v. *Dow Corning Corp.*, 822 F.2d 358, 362 (3d Cir. 1987); *Hershey Foods Corp.* v. *Ralph Chapek, Inc.*, 828 F.2d 989, 995 (3d Cir. 1987); *Thermice Corp.* v. *Visitron Corp.*, 832 F.2d 248, 252 (3d Cir. 1987); *Kroblin Refrigerated XPress, Inc.* v. *Pitterich*, 805 F.2d 96, 101 (3d Cir. 1986); *Air Master Sales Co.* v. *Northbridge Park Co-op, Inc.*, 748 F.Supp. 1110, 1114 (D.N.J. 1990); *Borbely* v.

Nationwide Mut. Ins. Co., 547 F.Supp. 959, 966 (D.N.J. 1981). An ambiguity in a contract exists if the terms of the contract are susceptible to at least two reasonable alternative interpretations. *Mellon Bank, N.A.* v. *Aetna Business Credit, Inc.*, 619 F.2d 1001, 1011 (3d Cir. 1980).

Construction of a contract's terms is a question of law. *Nevets C.M., Inc.* v. *Nissho Iwai Am. Corp.*, 726 F.Supp. 525, 531 (N.J. 1989), *aff'd mem.*, 899 F.2d 1218 (3d Cir. 1990); *Vanguard Telecommunications. Inc.* v. *Southern New England Tel. Co.*, 722 F.Supp. 1166, 1178 (D.N.J. 1989), aff'd 900 F.2d 645, 651 (3d Cir. 1990); *Ram Constr. Co.* v. *American States Ins. Co.*, 749 F.2d 1049, 1053 (3d Cir. 1984). The construction of an unambiguous term in a contract is "exclusively with[] the court." *Nevets*, 726 F.Supp. at 531; *Feist & Feist Realty Corp.* v. *Dockside Urban Renewal Corp.*, 255 N.J.Super. 100, 108 (Law Div. 1992) ("[w]here the language of a writing is clear and unambiguous and there is no credible evidence which could create doubt as to the meaning, the construction and effect of the writing is a matter of law to be determined by the court").

In interpreting the contract, the subjective, undeclared, intentions of the parties are immaterial, because manifestation of intention, as reflected in the language, controls. *Armco Inc.* v. *Glenfed Fin. Corp.*, 720 F.Supp. 1129, 1138 (D.N.J. 1989). To determine the meaning of the terms of an agreement by the objective manifestations of the parties' intent, the terms of the contract must be given their "plain and ordinary meaning." *Nevets*, 726 F.Supp. at 533.

In this case, the Termination Provision stated, in relevant part: "This Agreement ... shall ... continue in effect until July 31, 1989." 1984 Agreement, § 13.01. It is clear this term provided an expiration date for the 1984 Agreement. There was nothing in

the Termination Provision which suggests the parties contracted for an extension or renewal or an option for an extension or renewal of the 1984 Agreement upon its termination.

The parties contracted for the expiration of the contract on 31 July 1989. As a matter of law, it cannot be said that the Termination Provision was ambiguous. In fact, ISI does not contend that the Termination Provision was ambiguous.[12] "[W]here the terms of a contract are clear and unambiguous there is no room for interpretation or construction and the courts must enforce those terms as written." *Karl's Sales & Serv., Inc.* v. *Gimbel Bros., Inc.*, 249 N.J.Super. 487, 493 (App.Div.) (citing *Kampf* v. *Franklin Life Ins. Co.*, 33 N.J. 36, 43 (1960)), *certif. denied*, 127 N.J. 548 (1991).

b. The Parol Evidence Rule

ISI claims, in spite of the Termination Provision, that it always understood the relationship between it and CCC "would not be terminated except for good cause." Complaint, ¶ 14. In support of its argument, ISI seeks to present evidence extrinsic to the 1984 Agreement. CCC argues in response that in light of the Termination Provision and Merger Clause in the 1984 Agreement, any evidence produced by ISI to demonstrate this understanding

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[12] ISI's argument that "the absence of any provision in the 1984 Agreement for orderly transfer of existing customer accounts ... reflect[s] the parties' intention that their relationship would continue indefinitely into the future," ISI Opposition Brief at 5-6, does not render the Termination Provision ambiguous. There is no term in the 1984 Agreement which can be read to suggest the parties contemplated anything other than automatic expiration of the agreement on 31 July 1989. As discussed, in determining whether a contractual provision is ambiguous, only the terms in the agreement are to be considered in the determination of whether a contractual term is ambiguous. "[M]anifestation of intention, as reflected in the language, controls." *Armco*, 720 F.Supp. at 1138.

falls outside of the 1984 Agreement and thus is barred by the parol evidence rule. Moving Brief at 6-9.

The parol evidence rule is a matter of substantive contract law, not one of evidence. *Fr. Winkler KG* v. *Stoller*, 839 F.2d 1002, 1005 (3d Cir. 1988); *Atlantic N. Airlines, Inc.* v. *Schwimmer*, 12 N.J. 293, 302 (1953). Under the parol evidence rule, the clear and unambiguous terms of a valid, integrated written instrument cannot be contradicted or varied by prior or contemporaneous extrinsic oral or written evidence. *Filmlife. Inc.* v. *Mal "Z" Ena, Inc.*, 251 N.J.Super. 570, 573 (App.Div. 1991) (quoting *Ocean Cape Hotel Corp.* v. *Masefield Corp.*, 63 N.J.Super. 369, 378 (App.Div. 1960)); *Madison Indus., Inc.* v. *Eastman Kodak Co.*, 243 N.J.Super. 578, 588 (App.Div. 1990). As mentioned, "[t]he question of whether a term is clear or ambiguous is ... a question of law." *Air Master Sales*, 748 F.Supp. at 1114. Parol evidence (evidence from outside of the contract), however, may be introduced to establish the contract is not binding, voidable or the result of fraud or mistake. *Mellon Bank Corp.* v. *First Union Real Estate Equity & Mortgage Inv.*, 951 F.2d 1399, 1404-05 (3d Cir. 1991).

The necessary inquiry, therefore, begins with an examination of the language of the 1984 Agreement. "Before a court can apply the parol evidence rule, it must determine whether the parties have adopted a writing as the final and complete expression of their agreement." *Fr. Winkler*, 839 F.2d at 1005; *see Thermice*, 832 F.2d at 252; *Atlantic N. Airlines*, 12 N.J. at 302. If the contract appears to be "'complete within itself, couched in such terms as import a complete legal obligation without any uncertainty as to the object or extent of the engagement, it is conclusively presumed that the whole engagement of the parties, and the extent and manner of their undertaking were reduced to writing.'" *Mellon*, 951 F.2d at 1405 (citation omitted).

The 1984 Agreement appears without question to be a final and complete agreement between CCC and ISI. This is demonstrated by the length and detail of the contract. The 1984 Agreement was seventeen pages in length and included another twenty-three pages of appendices. *See generally* 1984 Agreement. The contract was also comprehensive of all aspects of the parties' agreement. It contained provisions detailing pricing, licensing and sub-licensing arrangements, insurance and indemnification, when and how the agreement could be terminated and further details of the rights and duties of each party. *Id.*

Most significantly, the 1984 Agreement contained a Merger Clause which clearly demonstrates the intent of the parties that the 1984 Agreement be recognized as their complete agreement. Specifically, the Merger Clause stated in part that the 1984 Agreement

> represents the entire agreement between the parties ... and shall supersede any other agreements, whether oral or written. *There are no understandings*, representations or warranties *of kind except as expressly set forth in this Agreement*.

Id., § 14.08 (emphasis added); *see Viceroy Fluid Power Int'l., Inc. v. Banks Engineering Co.*, 680 F.Supp. 725, 727 (W.D.Pa. 1988) (parol evidence inadmissible "particularly where the writing includes a clause prohibiting oral modifications").

The presence of an integrated agreement bars the introduction of inconsistent terms. *See Fr. Winkler*, 839 F.2d at 1005; *Thermice*, 832 F.2d at 252. Accordingly, "[a]ny evidence which cannot be read as consistent with the express terms of the contract, is simply irrelevant because of the principle that a contract will not

be given an interpretation that is in conflict with the express language." *Tigg*, 822 F.2d at 363.

The evidence ISI attempts to present of its belief that CCC would renew the 1984 Agreement directly contradicts the Termination Provision. As discussed, the Termination Provision was clear and unambiguous. Any evidence submitted by ISI that there was an extrinsic agreement or understanding that the 1984 Agreement would continue or be renewed is barred from consideration by the parol evidence rule because it is inconsistent with the Termination Provision.

> Absent an express option contract, a duty to contract beyond the terms of the contractual relationship itself is a contradiction in terms. This obtains in the face of the disappointed expectations of a party in the creation of a contract or the continuation of an existing one.

Rothermel, 163 N.J.Super. at 247.

c. The Enforceability of the Termination Provision

ISI argues that "[e]vidence to prove illegality, accident or mistake is admissible even though that evidence contradicts the terms of a complete integration in writing." ISI Opposition Brief at 15. ISI contends that the 1984 Agreement failed to reflect the true nature of the parties' agreement to enter into a relationship which would continue indefinitely. In addition, ISI argues the Termination Provision was unlawful because it violated New Jersey public policy which dictates that failure to renew in a franchise situation must be justified by good cause. *Id.* at 14. ISI argues, therefore, that it should be allowed to submit evidence of the Termination Provision's unenforceability.

As mentioned, parol evidence may be introduced in the event the contract is the result of fraud or mistake or is voidable or not binding. *See Mellon*, 951 F.2d at 1404. If the Termination Provision was unenforceable, parol evidence rule cannot bar evidence to that effect. As discussed below, however, those exceptions do not apply to the instant case. In addition, even if the "evidence" supporting the ISI belief that its relationship with CCC would continue indefinitely were considered, such evidence fails to establish a genuine issue of material fact.

i. Mistake

"The doctrine of mutual mistake applies when a 'mistake was mutual in that both parties were laboring under the same misapprehension as to [a] particular, essential fact.'" *Bonnco Petrol, Inc.* v. *Epstein*, 115 N.J. 599, 608 (1989) (quoting *Beachcomber Coins, Inc.* v. *Boskett*, 166 N.J.Super. 442, 446 (App.Div. 1979)). Mutual mistake "requires that both parties are in agreement at the time they attempt to reduce their understanding to writing, and the writing fails to express that understanding correctly." *St. Pius X House of Retreats, Salvatorian Fathers* v. *Diocese of Camden*, 88 N.J. 571, 579 (1982).

If a contract deviates in whole or in part from the agreement between the parties because of a mutual mistake, a court may reform the contract to express the actual terms of the agreement. *Bonnco Petrol*, 115 N.J. at 608. Under New Jersey law, the party seeking reformation must establish that "the minds of the parties have met and reached a prior existing agreement, which the written document fails to express." *Id.*

ISI contends it had an understanding with CCC that their relationship would continue indefinitely and suggests this is a reason for not applying the parol evidence rule in the instant case.

ISI Opposition Brief at 5-6, 15. This understanding is based on three particular incidents. None of those incidents, however, demonstrates that CCC ever promised ISI an exclusive distributorship in perpetuity. These incidents, therefore, do not illustrate the mutuality of the understanding, as required to establish mutual mistake.

First, ISI contends Suppes told Kaminer, at the beginning of the relationship, that "ISI would continue to be CCC's sole and exclusive distributor as long as ISI was able to meet reasonable marketing quotas." ISI Opposition Brief at 5; Kaminer Certif., ¶ 40. Despite this alleged statement by Suppes, Kaminer signed the 1975 Agreement which limited the term of the contract to 30 June 1977 and included a merger clause which stated that the written terms constituted the parties entire agreement. 1975 Agreement, ¶¶ XVIII, XXXI.

In 1977, when the parties were negotiating the 1978 Agreement, Kaminer wrote a letter with her comments on the then proposed agreement. *See* Letter, dated 1 August 1977, from Kaminer to "Joe," attached as Exhibit F to the Rosdeitcher Aff. One of her comments stated: "Region I cannot be withdrawn, ever and II and III cannot be withdrawn if quotas are met.... Term of agreement should not involve Group I and can only be cancelled after that time if quotas not met for II and III." *Id.*; *see* CCC Moving Brief at 10. CCC argues this was an attempt to obtain for ISI "perpetual distribution rights in certain states" and, in the other states, to establish rights which could only be cancelled if quotas were not met. CCC Moving Brief at 10. As illustrated by paragraph 9.4 of the 1978 Agreement which allowed either party to terminate the agreement upon thirty days' notice, Kaminer's comments were neither adopted nor the subject of agreement.

Throughout the relationship between ISI and CCC, ISI signed subsequent contracts with similar provisions, which allowed either party to terminate the contract with notice to the other after a specific date or set a particular expiration date for the contract. *See* 1978 Agreement, ¶ 9.4; 1980 Agreement, ¶ 9.4; 1984 Agreement, § 13.01; 1989 Agreement, § 13.1. Each contract between ISI and CCC also contained a merger clause which stated that the written agreement embodied the parties' *entire* agreement. *See* 1978 Agreement, Article XIX; 1980 Agreement, Article XX; 1984 Agreement, § 14.08; 1989 Agreement, § 14.8. Not only was ISI aware of those provisions, which conflict with its now asserted belief, but ISI also agreed with the rationale behind the need to have time limitations on the contractual period. ISI Opposition Brief at 5; Kaminer Certif., ¶ 24; Kaminer Dep. Tr. at 41-42.

Second, ISI refers to the 27 June 1977 Letter as proof that CCC and ISI had an understanding that the relationship would be continuous. The letter stated in pertinent part:

> Upon reflection, putting in the milestones on the north and south territories at the end of three years did not make much sense unless the contract were to continue after those dates. We are therefore writing a five-year contract with no conditions on the core territory as we discussed when you were here.

27 June 1977 Letter. Clearly the 27 June 1977 Letter stated that the next agreement would be for a term of five years. ISI does not explain how its understanding reconciles with the contemplated five-year time limitation.

The third basis for ISI's understanding is a statement allegedly made by Suppes sometime in the mid-1970s to Kaminer

that she was "queen of the east coast." Specifically, Kaminer recalled that

> [Suppes] made a remark that always struck me and I remembered it very well in which he said he was very pleased with the work we were doing and, ... he said a lot of things but the one of the remarks that I remember him saying was, as far as I'm concerned, you're queen of the east coast.

Kaminer Dep. Tr. at 30. Drawing from this statement the most favorable inferences possible, this alleged statement cannot possibly be construed as a promise by CCC to forever grant ISI an exclusive distributorship for CCC products. At best, it can be construed as an indication CCC believed that in the mid-1970's, ISI was doing a good job as a distributor of CCC products.

None of the evidence ISI wishes to present indicates that CCC agreed ISI would have a perpetual exclusive distributorship or that the Termination Provision was included in the 1984 Agreement through the mutual mistake of the parties. This is especially so in light of the overwhelming evidence to the contrary—the clear language in each agreement regarding termination and CCC's rejection of Kaminer's proposal that the parties establish such a continuous relationship.[32]

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[32] Even if the facts could be construed so as to demonstrate that ISI had a unilateral understanding it had an exclusive distributorship in perpetuity, this would not be enough to hold the Termination Provision unenforceable. Rescinding a provision of a contract based on a unilateral mistake of one of the parties requires that

> the mistake ... be of so great a consequence that to enforce the contract as actually made would be unconscionable.

(continued...)

ii. Unconscionability/Illegality

ISI argues throughout its opposition to the CCC summary judgment motion that the Termination Provision was unconscionable. ISI Opposition Brief at 10, 18, 22. ISI further suggests the unconscionability of the Termination Provision provides a basis for not applying the parol evidence rule. *Id.* at 15.

"The doctrine of unconscionability comes into play when two factors coincide: 'grossly disproportionate bargaining power' between the parties which has in fact led to 'grossly unfair contractual provisions.'" *Jefferson Loan Co. v. Livesay*, 175 N.J.Super. 470, 479 (Law Div. 1980) (quoting *Shell Oil Co.* v. *Marinello*, 63 N.J. 402, 408 (1973), *cert. denied*, 415 U.S. 924 (1974)); *cf. Woolley v. Hoffmann-La Roche, Inc.*, 99 N.J. 284, 303 (doctrine of unconscionability of Uniform Commercial Code "developed to protect the disadvantaged party in a one-sided bargain"), *modified on other grounds*, 101 N.J. 10 (1985); *Humble Oil & Refining Co. v. Doerr*, 123 N.J.Super. 530, 564 (Ch.Div. 1973) (applying equitable principles in action brought to enforce purchase option). Where a contract or one of its terms is unconscionable, "nonenforcement of its terms may be justified on other than such traditional grounds as fraud, duress, mistake or illegality." *Rudbart* v. *Water Supply Comm'n*, 127 N.J. 344, 353, *cert. denied sub nom., First Fidelity Bank, N.A.* v. *Rudbart*, ___ U.S. ___, 113 S.Ct. 203 (1992).

[W](...continued)
1949)).

As discussed below, there is no indication that enforcement of the Termination Provision was unconscionable. Accordingly, the first element of unilateral mistake is missing. In addition, the facts proffered by ISI to demonstrate mistake do not support a reasonable belief on the part of ISI that it had an exclusive distributorship in perpetuity.

The primary basis of ISI's argument that the Termination Provision was unconscionable is that the provision violated public policy. ISI relies primarily on the case of *Shell*, 63 N.J. 402, for its argument. ISI Opposition Brief at 15-18. The *Shell* court stated:

> Where there is grossly disproportionate bargaining power, the principle of freedom to contract is non-existent and unilateral terms result. In such a situation, courts will not hesitate to declare void as against public policy grossly unfair contractual provisions which clearly tend to the injury of the public interest in some way.
>
> *Id.* at 408.

Shell involved a set of agreements, including a lease and a distribution agreement, between Shell Oil Company ("Shell") and the plaintiff who was one of Shell's service station operators. Over a ten year period, Shell and the plaintiff entered into agreements which had one-year terms but were regularly renewed upon their expiration. The last set of agreements between Shell and the plaintiff was for a three-year term and either party was allowed to terminate the agreements upon notice to the other party after the expiration of the three-year period. Upon the expiration of the three-year period, Shell gave the plaintiff notice that it was terminating the agreements; the plaintiff sued to enjoin such termination. The New Jersey Supreme Court determined that the provisions in the agreements which allowed Shell to terminate the contracts at will were the "result of Shell's disproportionate bargaining position and [were] grossly unfair." Id. at 409.

The court in *Shell* stressed the importance of the particular facts in its decision. *Id.* at 407. The disparity of bargaining power which existed between Shell and the plaintiff and led the court to determine that the termination-at-will provision was "grossly

unfair," does not exist in this case. Shell, a "major oil company," sold its products in "hundreds of Shell service stations throughout the State." *Id.* at 404, 407. Shell's impact on the state was so great the court determined that the "public is affected in a direct way." *Id.* at 409. The factual situation in the instant case does not approach the circumstances in *Shell*.

The instant case involves two privately owned and run companies. CCC is not a company of the magnitude of Shell and the only presence it has in the state of New Jersey is through its arrangement with ISI. The relationship between Kaminer, with her impressive educational background and experience in the field of computers, and Suppes, who also has an impressive background in developing programs for computer-assisted education, does not present the "gross disparity in bargaining power" that concerned the *Shell* court. The fact ISI, at one point, put together an offer with the intent of purchasing CCC, further belies the type of disparity necessary to find a contractual arrangement unconscionable.

A common theme underlying cases which have found contracts to be unconscionable is the notion that the plaintiff is not the only person or entity at risk of being harmed by defendant's actions. Cases which have found the disparity in bargaining power to have risen to the level of unconscionability have also found that the general public is threatened in some way by the actions of the defendant. This is illustrated by the cases cited by ISI. *See, e.g., Rudbart*, 127 N.J. at 356; *Ellsworth Dobbs, Inc.* v. *Johnson*, 50 N.J. 528, (1967); *Henningsen* v. *Bloomfield Motors, Inc.*, 32 N.J. 358, 404 (1960); *Shell*, 63 N.J. at 409. In the instant case, to the contrary, CCC's actions pose no threat to the general public.

ISI relies on the holding in *Shell* to argue that New Jersey public policy, as the uncodified version of the Franchise Practices Act, dictates that the Termination Provision was unconscionable. The holding in *Shell* was guided in part by the then recent enactment of the Franchise Practices Act. *Id.* Although the dispute between Shell and the plaintiff arose prior to the enactment of the Franchise Practices Act, the court stated that the statute

> reflects the legislative concern over long-standing abuses in the franchise relationship, particularly provisions giving the franchisor the right to terminate, cancel, or fail to renew the franchise. To that extent the provisions of the [Franchise Practices] Act merely put into statutory form the extant of public policy of [the] state [of New Jersey].

Id. To the extent ISI argues that New Jersey common law dictates the same results upon extraterritorial application as the Franchise Practices Act, those arguments fail.

To the extent ISI argues that New Jersey common law public policy prohibits franchisors from terminating a franchise without good cause, the argument fails because such a policy would be preempted by the Franchise Practices Act. *See Horn*, 265 N.J.Super. at 53 n.2; *Tynan*, 248 N.J.Super. at 670; *see Freedman Truck*, 784 F.Supp. at 178.

As discussed, in order for common law to apply, ISI would have to be found not to be a franchisee under the Franchise Practices Act and/or the extraterritorial application of the act would have to be precluded. In the event ISI is found not to have a franchise, the public policy, as described by ISI, would not apply.

If the application of the Franchise Practices Act outside of New Jersey violates the Commerce Clause, the extraterritorial

application of any analogous public policy is similarly barred for the reasons articulated in *Instructional Systems II.* A state's common law is not immune from constitutional restrictions.

In *New York Times Co.* v. *Sullivan*, 376 U.S. 254 (1964), the Supreme Court stated:

> Although this is a civil lawsuit between private parties, the Alabama courts have applied a state rule of law which petitioners claim to impose invalid restrictions on their constitutional freedoms of speech and press. It matters not that that law has been applied in a civil action and that it is common law only, though supplemented by statute.... The test is not the form in which state power has been applied but, whatever the form, whether such power has in fact been exercised.

Id. at 265; *see also Adickes* v. *S.H. Kress & Co.*, 398 U.S. 144, 171 (1970) ("[f]or state action purposes it makes no difference ... whether [an] act ... is compelled by a statutory provision or by a custom having the force of law"); *Nashville, Chattanooga & St. Louis Ry.* v. *Browning*, 310 U.S. 362, 369 (1939) (in determining a constitutional violation, Court stated "[i]t would be a narrow conception of jurisprudence to confine the notion of "laws" to what is found written on the statute books").

ISI cannot escape the determination that extraterritorial application of the Franchise Practices Act violates the Commerce Clause by contending that uncodified New Jersey public policy achieves the same result in the act's absence. New Jersey common law public policy may not accomplish that which cannot be accomplished by New Jersey statutes.

4. Count 3—Breach of Implied Covenant of Good Faith and Fair Dealing

As a general rule, courts may not write into a contract provisions which the parties omitted or to modify terms to which they agreed in the absence of equitable reasons to the contrary.

> [W]here the terms of a contract are clear and unambiguous there is no room for interpretation or construction and the courts must enforce those terms as written.... [C]ourts [may not] remake a better contract for the parties than they themselves have seen fit to enter into, or alter it for the benefit of one party and to the detriment of the other.

Karl's Sales, 249 N.J.Super. at 493 (citations omitted); *see James* v. *Federal Ins. Co.*, 5 N.J. 21, 24 (1950); *Moscowitz* v. *Middlesex Borough Bldg. & Loan Ass'n*, 14 N.J.Super. 515, 521 (Law Div. 1951), *aff'd*, 18 N.J.Super. 182 (App.Div. 1952).

Against this backdrop, an exception to the general rule is the implied covenant of good faith and fair dealing.

> "In every contract, there is an implied covenant that 'neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract; in other words, in every contract there exists an implied covenant of good faith and fair dealing.'"

W.V. Pangborne & Co. v. *New Jersey Dep't of Transp.*, 116 N.J. 543, 560 (1989) (citations omitted); *see Pickett* v. *Lloyd's*, 131 N.J. 457, 467 (1993); *Noye* v. *Hoffmann-La Roche, Inc.*, 238 N.J.Super. 430, 432 (App.Div.), *certif. denied*, 122 N.J. 146 (1990); *Bak-A-Lum Corp. of Am.* v. *Alcoa Bldg. Prods., Inc.*, 69

N.J. 123, 129-30 (1976); *Palisades Properties, Inc.* v. *Brunetti*, 44 N.J. 117, 130 (1965); *see also W.A. Wright, Inc.* v. *KDI Sylvan Pools, Inc.*, 746 F.2d 215, 218 (3d Cir. 1984). A covenant of good faith and fair dealing "involve[s] an implied duty to bring about a condition or to exercise discretion in a reasonable way." *USX Corp.* v. *Prime Leasing, Inc.*, 988 F.2d 433, 435 (3d Cir. 1993). Such implied terms are interpreted in accordance with principles of commercial reasonableness. *See Glenside West Corp.* v. *Exxon Co., U.S.A., Div. of Exxon Corp.*, 761 F.Supp. 1100, 1112 (D.N.J. 1991).

The Complaint alleges that CCC's refusal to renew the exact terms of the 1984 Agreement constitutes a breach of implied covenant. *See* Complaint, ¶ 49. However, ISI's request that a renewal term be read into the 1984 Agreement, requiring CCC to extend or renew the exact terms of the 1984 Agreement upon its expiration on 31 July 1989, directly contravenes a written provision in the contract.

While certain unwritten covenants may be implied to effect the true meaning of a contract's terms, "'it is not the province of the court to make a new contract or supply any material stipulations or conditions which contravene the agreements of the parties.'" *Onderdonk* v. *Presbyterian Homes of N.J.*, 85 N.J. 171, 183 (1981) (citation omitted).

> "The law will imply a term only for omitted covenants. There can be no implied covenant as to any matter specifically covered by the written contract between the parties." Thus it is only "[i]n the absence of an express provision, [that] the law will imply an agreement by the parties to a contract to do and perform those things that according to reason and justice they should do in order to carry out the purpose for which the contract was made...."

USX Corp., 988 F.2d at 439 (citations omitted); *see Borbely*, 547 F.Supp. at 975.

In an analogous case, the court in *Rothermel*, 163 N.J.Super. 235, declined to impose liability based on a breach of implied covenant of good faith and fair dealing. *Id.* at 248. In that case, the plaintiff, a company which bought paper from the manufacture and then resold it, sued the defendant paper manufacturer based on the defendant's refusal to renew the supply contracts. The defendant determined that it would be more efficient for it to eliminate the plaintiff and directly sell its own products. The defendant gave the plaintiff notice, as required under the written agreements, and terminated the supply contracts.

> Recognition of the consensual nature of the contract relationship necessarily includes the right of one not to consent to such a relationship. If one were to be held liable in tort for rejection of an offer to contract or for termination of an existing contractual relationship according to its terms, the characteristically consensual nature of the contract relationship would be undermined. Absent an express option contract, a duty to contract beyond the terms of the contractual relationship itself is a contradiction in terms.[24]

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[24] ISI argues that the Termination Provision should be overridden by the implied covenant of good faith and fair dealing and cites *Bak-a-Lum*, 69 N.J. 123, in support of that proposition. ISI Opposition Brief at 20. The decision in *Bak-A-Lum*, however, is factually and legally distinguishable from the instant case.

Bak-A-Lum, involved a suit by an aluminum siding salesman against the aluminum siding manufacturer. The parties entered into an oral agreement whereby the plaintiff was made the exclusive distributor of the defendant's products in northern New Jersey. Several years later, with no warning to the plaintiff, the defendant appointed four other salespeople to distribute its products

(continued...)

Id.

ISI argues that "[w]here a term of the contract contains an implied covenant of good faith and fair dealing, then such a covenant will be implied as a term of the contract or give rise to a duty between the parties." ISI Opposition Brief at 19. ISI, essentially, advocates the implication of a covenant in the 1984 Agreement which would be in direct contravention of an express and unambiguous provision in that contract. As a matter of law, that proposition is not acceptable. *See USX Corp.*, 988 F.2d at 439; *Borbely*, 547 F.Supp. at 975.

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[49](...continued)
in the area assigned to the plaintiff. The plaintiff sued to enjoin the termination of his exclusive distributorship without "good cause." The trial court refused to issue a preliminary injunction, but did find that the parties had a binding agreement and that the agreement was terminable only upon a "reasonable" notice period. The trial court then determined a reasonable notice period consisted of seven months.

On appeal, the New Jersey Supreme Court determined that twenty months was a reasonable notice period. Specifically, the court stated that while "[i]t may be true that [the] defendant ordinarily would be under no strictly legal obligation to inform [the] plaintiff that it was about to terminate its exclusive distributorship," the implied covenant of good faith and fair dealing justified such a result under the circumstances of the case. *Id.* at 129-30. It is clear that the court in *Bak-A-Lum* was not imposing an inconsistent term to the existing agreement between the parties. Rather, the court first read a provision requiring reasonable notice into an oral agreement, and then interpreted "reasonable notice" to constitute twenty months under the circumstances of that case.

To the contrary, there is no provision in the 1984 Agreement which is in similar need of interpretation. As discussed, the Termination Provision clearly and unambiguously provided for the expiration of the 1984 Agreement as of 31 July 1989. No action was required on the part of ISI or CCC; the agreement simply expired by its terms. Any attempt to imply into the 1984 Agreement an obligation to renew would directly contradict the Termination Provision.

ISI and CCC agreed in the 1984 Agreement, as they had in previous agreements, that the term of the contract would extend only until a definite date. The parties did not include any provisions in the 1984 Agreement which dictated that the parties take some particular action upon the expiration of the contract or even give notice of termination. Specifically, there was no provision which required CCC to automatically renew the 1984 Agreement. Accordingly, the 1984 Agreement clearly contemplated termination in 1989 without further action.

CCC did nothing to damage any of ISI rights under the 1984 Agreement. On 31 July 1989, the 1984 Agreement terminated in accordance with its provisions; the parties were then free to enter into a new contract. ISI had no enforceable legal right under the 1984 Agreement to have the 1984 Agreement renewed or continued in the exact same form. There are no genuine issues of material fact which would preclude summary judgment as to Count Three.

5. Count 4—Tortious Interference with Prospective Economic Advantage

The Complaint alleges that the "acts and omissions of CCC [in refusing to renew the exact terms of the 1984 Agreement] constitute tortious interference with ISI's prospective economic advantage in that, *inter alia*, business relationships between ISI and prospective customers have been and will be interfered with by CCC."[15] Complaint, ¶ 52.

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[15] This claim is based on CCC's alleged interference with ISI's prospective relationships with potential customers of CCC products and not on the non-renewal of the 1984 Agreement. Accordingly, it appears ISI satisfies the requirement that "a cause of action sounding in tortious interference with

(continued...)

The legal rationale behind a claim of tortious interference with prospective economic advantage is to protect interests in reasonable expectations of economic advantage from outside interference. *Printing Mart-Morristown* v. *Sharp Elecs. Corp.*, 116 N.J. 739, 750, 752 (1989); *C.R. Bard, Inc.* v. *Wordtronics Corp.*, 235 N.J.Super. 168, 171-72 (Law Div. 1989). In New Jersey, an action for tortious interference with prospective business relations "protects the right 'to pursue one's business, calling or occupation free from undue influence or molestation.'" *Printing Mart-Morristown*, 116 N.J. at 750 (quoting *Louis Kamm, Inc.* v. *Flink*, 113 N.J.L 582, 586 (E&A 1934)). A *prima facie* case entails the "'luring away, by devious, improper and unrighteous means, of the customer of another.'" *Printing Mart-Morristown*, 116 N.J. at 750 (quoting *Kamm*, 113 N.J.L. at 586).

Under New Jersey law, the following elements must be proven to establish a cause of action for tortious interference with prospective economic advantage: (1) a reasonable expectation by the plaintiff of an economic advantage; (2) the defendant's knowledge of that expected economic advantage; (3) the defendant's malicious interference with the plaintiff's expected economic advantage; (4) that without the defendant's interference, it was reasonably probable that the plaintiff would have realized the economic advantage; and (5) that the plaintiff was damaged by the defendant's interference. *See Printing Mart-Morristown*, 116 N.J. at 750; *Rainier's Dairies* v. *Raritan Valley Farms, Inc.*, 19 N.J. 552, 563 (1955); *Zippertubing Co.* v. *Teleflex, Inc.*, 757 F.2d 1401, 1409 (3d Cir. 1985); *Michael Halebian N.J., Inc.* v. *Roppe Rubber Corp.*, 718 F.Supp. 348, 361 (D.N.J. 1989).

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[19](...continued)
contractual obligations ... be directed against a third party." *Kopp. Inc.* v. *United Technologies, Inc.*, 223 N.J.Super. 548, 559 (App.Div. 1988).

Generally, the claim must be based on a cognizable right such as an economic or contractual relationship and the interference with that right must be intentional and malicious. *Printing Mart-Morristown*, 116 N.J. at 751. Such interference, moreover, must have caused the loss of the prospective gain which must cause damage to the plaintiff. *Id.* at 751-52.

Malice connotes committing a wrongful act intentionally, without justification or excuse. A malicious act is

> "any act which will, in the ordinary course, infringe upon the rights of another to his damage, *except and unless it be done in the exercise of an equal or superior right.*"

Kopp, 223 N.J.Super. at 560 (emphasis in original) (citation omitted); *see Levin* v. *Kuhn Loeb & Co.*, 174 N.J.Super. 560, 573 (App.Div. 1980); *Trump Taj Mahal Assoc.* v. *Costruzioni Aeronautiche Giovanni Agusta, S.p.A.*, 761 F.Supp. 1143, 1163 (D.N.J. 1991) (citing *Norwood Easthill Assocs.* v. *Norwood Easthill Watch*, 222 N.J.Super. 378, 384-85 (App.Div. 1988)), *aff'd mem.*, 958 F.2d 365 (3d Cir.), *cert. denied*, __ U.S. __, 113 S.Ct. 84 (1992); *Labus* v. *Navistar Int'l Transp. Corp.*, 740 F.Supp. 1053, 1063 (D.N.J. 1990); *Borbely*, 547 F.Supp. at 976. In other words, "[t]hat which one has a right to do cannot become a tort when it is done." *Rothermel*, 163 N.J.Super. at 244; *Kopp*, 223 N.J.Super. at 560; *see also Glasofer Motors v. Osterlund, Inc.*, 180 N.J.Super. 6, 26 (App.Div. 1981).

The facts, construed in a light most favorable to ISI, show that CCC was not under any contractual obligation to renew the 1984 Agreement. As mentioned, the 1984 Agreement contained an express provision for automatic termination on 31 July 1989. CCC had a right to allow the 1984 Agreement to expire on 31 July 1989. Accordingly, the element of malice is not present in the

instant case because CCC had no contractual obligation to renew the 1984 Agreement. In *Kopp*, the court determined that there was no tortious interference because the defendant had no contractual obligation to act in the way plaintiff desired. *Id.* at 560.

In response, ISI contends that CCC, by arguing that it had no contractual obligation to renew the 1984 Agreement,

> assumes a right which the New Jersey Supreme Court has held CCC did not have, *i.e.*, the right to terminate ISI without good cause.
>
> As set forth above, the New Jersey Supreme Court has decided that the nature of the relationship between ISI and CCC is that of a franchise. As a matter of public policy of this State, that relationship could not be terminated without good cause.

ISI Opposition Brief at 22. This argument ignores several facts. First, the argument confuses the issues raised by Count One under the Franchise Practices Act with those raised by Count Four which is a common law count. As discussed, to the extent the Franchise Practices Act governs the parties' dispute, Count Four is preempted. Second, only a few specific issues, all involving a portion of Count One, were remanded to the state courts. The New Jersey Supreme Court in *N.J. Sup. Ct. Instructional Systems* was, therefore, never presented with Count Four or, for that matter, any of the Common Law Counts, and, indeed, never addressed such issues.

CCC, had a contractual right to permit the 1984 Agreement to expire with respect to the Eight states and, in fact, the Marketing Territory. Accordingly, CCC, as a matter of law, cannot be determined to have tortiously interfered with ISI's

prospective economic disadvantage. Summary judgment as to Count Four is, therefore, appropriate.

6. Count 5—Unfair Competition

ISI alleges that there was "a covenant of non-competition by CCC implied by the relationship and the [1984] Agreement" which CCC breached by failing to renew the 1984 Agreement as to the Eight States. *See* Complaint, ¶ 55. Accordingly, ISI alleges a claim of unfair competition.

The elements of a cause of action for unfair competition were set out in *C.R. Bard.*

> "One who intentionally causes a third person not to enter into a prospective contractual relation with another *who is his competitor* or not to continuing an existing contract terminable at will does not interfere improperly with the other's relation if
> (a) the relation concerns a matter involved in the competition between the actor and the other and
> (b) the actor does not employ wrongful means and
> (c) his action does not create or continue an unlawful restraint of trade and
> (d) his purpose is at least in part to advance his interest in competing with the other.

235 N.J.Super. at 172 (citation omitted) (emphasis added); *see also American Shops, Inc.* v. *American Fashion Shops of Journal Square*, 13 N.J.Super. 416, 424 (App.Div.), *certif. denied*, 7 N.J. 576 (1951).

ISI has failed to satisfy the preliminary requirement for unfair competition which is that ISI and CCC be competitors. *See*

New Jersey Optometric Ass 'n v. *Hillman-Kohan Eyeglasses, Inc.*, 144 N.J.Super 411, 428 (Ch.Div. 1976) (court dismissed unfair competition claim because the plaintiff was a trade association which could not be in competition with defendants), *aff'd*, 160 N.J.Super. 81 (App.Div. 1978). The 1989 Agreement does not result in CCC competing with ISI in the Eight States or the Three State Marketing Territory. ISI maintains its exclusive distributorship in the Three State Marketing Territory and has no right to sell CCC products in the Eight States. Accordingly, the necessary element of competition is missing.

Furthermore, there are no facts which suggest CCC used unlawful or wrongful means to terminate ISI's ability to market CCC products in the Eight States. As discussed, the 1984 Agreement contained an explicit Termination Provision which imposed a definite time limitation on the 1984 Agreement. Accordingly, termination of the 1984 Agreement by CCC was not unlawful or wrong.

7. Count 6—Unjust Enrichment

ISI alleges that

> The aforesaid acts and omissions of ... CCC, including but not limited to the withdrawal of certain states from ISI's exclusive territory, constitutes unjust enrichment in that ISI, at the direction of CCC, has expended substantial resources in developing those territories under it [f)ranchise and CCC will reap the benefits of ISI's efforts.

Complaint, ¶ 58.

"The doctrine of unjust enrichment rests on the equitable principle that a person shall not be allowed to enrich himself at the expense of another." *Associates Commercial Corp.* v *Wallia*, 211 N.J.Super. 231, 243 (App.Div. 1986) (citing *Callano* v. *Oakwood Park Homes Corp.*, 91 N.J.Super. 105, 108 (App.Div. 1966)); *see also Dunkin' Donuts*, 100 N.J. at 184; *Insulation Contracting & Supply* v. *Kravco, Inc.*, 209 N.J.Super. 367, 375 (App.Div. 1986) ("invoked to prevent unjust enrichment of unconscionable benefits or advantage"). "The key words are enrich and unjustly." *Callano*, 91 N.J.Super. at 109.

The concept of unjust enrichment is based on a quasi-contractual relationship imposed for equitable reasons.

> Contracts implied by law, more properly described as *quasi* or constructive contracts ... rest solely on a legal fiction and are not contract obligations at all in the true sense.... Courts employ the fiction of *quasi* or constructive contract with caution.

Callano, 91 N.J.Super. at 108; *see Russell-Stanley Corp.* v. *Plant Indus.*, 250 N.J.Super. 478, 509 (Ch.Div. 1991).

Under New Jersey law, the existence of a valid contract is a bar to a finding of unjust enrichment. *Van Orman* v. *American Ins. Co.*, 680 F.2d 301, 311 (3d Cir. 1982).

> "It is a 'well settled rule that an express contract excludes an implied one. An implied contract cannot exist when there is an existing express contract about the identical subject. The parties are bound by their agreement, and there is no ground for implying a promise. It is only when the parties do not agree that the law interposes and raises a promise. When an express contract exists, there must be a rescission of it before

> the parties will be remitted to the contract which the law implies, in the absence of that agreement which they made for themselves.'"

C.B. Snyder Realty Co. v. *National Newark & Essex Banking Co.*, 14 N.J. 146, (1953) (quoting *Moser* v. *Milner Hotels, Inc.*, 6 N.J. 278, 280-81 (1951) (citation omitted).

The court in *St. Paul Fire & Marine Ins. Co.* v. *Indemnity Ins. Co.*, 32 N.J. 17 (1960) stated:

> [I]f the conduct of [the] defendant, objectively viewed, reveals a promise to pay, [the] defendant must meet that obligation whatever may have been its unrevealed expectation.

Id. at 24. Unless the "plaintiff, on the strength of [the] defendant's promise, [did] anything more or different from what it would or should have done in discharge of its own obligations," there is no unjust enrichment. *Id.* at 26. A crucial tenet of the doctrine of unjust enrichment is "'that the plaintiff expected remuneration from the defendant, or if the true facts were known to plaintiff, he would have expected remuneration from defendant, at the time the benefit was conferred.'" *Associates Commercial*, 211 N.J.Super. at 244 (quoting *Callano*, 91 N.J.Super. at 109).

In the instant case, there was a valid contract involving the identical subject upon which ISI seeks relief. There is nothing to suggest CCC was enriched beyond its contractual right. It appears that ISI's investments in CCC products and equipment and the work it undertook in promoting CCC products and building good will in the Marketing Territory fell within the obligations of the various contracts between ISI and CCC. Indeed, because of ISI's position as a distributor of CCC products, it is logical to view such

efforts as necessary for ISI's success and profitability. Construing all facts and drawing all inferences in favor ISI and assuming ISI did everything it contends it did in building a market for CCC products in the northeastern United States, there is no basis for a finding of unjust enrichment in light of ISI contractual obligations under the 1984 Agreement.

8. Count 7—Breach of Fiduciary Duty

ISI asserts, in count seven of the Complaint, that CCC breached its fiduciary duty to ISI by "consistently requir[ing] specific terms to be in the [1989] Agreement as a result of its superior bargaining position, and ISI is given little opportunity to negotiate terms of the [1989] Agreement." Complaint, ¶ 63. ISI further claims CCC's fiduciary duty arose from "a vast disparity in the relative bargaining positions as well as business knowledge and expertise between CCC and ISI in terms of bargaining position." *Id.*, ¶ 62. ISI, therefore, argues a fiduciary relationship existed between it and CCC, that by virtue of that relationship ISI was susceptible to the exertion of undue influence over it by CCC and that it was harmed by CCC's decision not to renew the exact terms of the 1984 Agreement. ISI Opposition Brief at 28-29.

ISI further implies that its position as a franchisee under the Franchise Practices Act further supports the existence of a fiduciary duty on the part of CCC. *See* ISI Opposition Brief at 28-30. This argument demonstrates ISI, once again, has confused its claims under the Franchise Practices Act with its Common Law Counts. As discussed, to the extent the Franchise Practices Act governs this dispute, Count Seven is preempted.

No fiduciary relationship automatically exists between a franchisor and franchisee under New Jersey law. *Glenside West*, 761 F.Supp. at 1116; *see Sandler* v. *Lawn-A-Mat Chem. & Equip.*

Corp., 141 N.J.Super 437, 450-51 (App.Div.) ("no special relationship" between distributor and franchisor), *certif. denied*, 71 N.J. 503 (1976); *Newark Motor Inn Corp.* v. *Holiday Inns, Inc.*, 472 F.Supp. 1143, 1151-52 (D.N.J. 1979).

Instead, it must be determined from the factors of ISI's relationship with CCC whether CCC owed a fiduciary duty to ISI and whether it breached that duty.

> A fiduciary relationship is one founded on trust or confidence placed by one person in the integrity and fidelity of another person. Out of such a relation, the law requires that neither party exert undue influence or pressure upon the other, take selfish advantage of his trust in such a way as to benefit himself or prejudice the other except in the exercise of the utmost good faith and with full knowledge and consent of the other person involved.

Glenside West, 761 F.Supp. at 1116 (citing *Arnott* v. *American Oil Co.*, 609 F.2d 873, 881 n.7 (8th Cir. 1979), *cert. denied*, 446 U.S. 918 (1980)).

While ISI attempts to portray a "Goliath/David" inequality in its relationship with CCC, the facts belie such a characterization. Even under the assumption that ISI is a franchise, ISI and CCC's relationship is unlike that of a typical franchise where the franchisor is an entity of "nationwide size, purchasing power and technical know-how" and the franchisee is a only a local entrepreneurship. *See Newark Motor Inn*, 472 F.Supp. at 1152. As explained, at the outset of their relationship, ISI and CCC were both relatively small companies privately owned by sophisticated persons knowledgeable about the computer industry.

CCC was not a national corporation seeking to establish a nation-wide chain of CCC distributors, rather it was a small company which had experienced regional success in marketing the educational software and hardware it had created. ISI appears to have been founded for the express purpose of selling educational software and hardware. In fact, ISI was engaged in that business prior to its relationship with CCC; ISI sought out CCC. Although CCC had contemplated expanding its marketing efforts into the northeastern United States, it does not appear that CCC had taken any specific steps in that direction until it was approached by ISI. Further undercutting any characterization of ISI's relationship with CCC as a Goliath/David situation, is the undisputed fact that ISI attempted to buy CCC in 1985.

From the facts presented, it cannot be said Kaminer and Suppes were anything other than arms-length bargaining parties. ISI attempts to recharacterize the relationship based on its alleged unilateral belief that CCC would continue unchanged the relationship with ISI indefinitely. There are no genuine issues of material fact indicating CCC occupied a position of fiduciary trust for ISI or lulled or misled ISI into the belief their relationship could not be changed.

Conclusion

For the foregoing reasons, CCC's summary judgment motion is granted as to that portion of Count One which alleges a violation of N.J.S.A. § 56:10-5 and as to Counts Two through Seven;

CCC's summary judgment motion is denied as to that portion of Count One which alleges a violation of N.J.S.A. § 56:10-7(e).

An order accompanies this opinion.

/s/
ALFRED J. LECHNER, JR., U.S.D.J.

AJL:dmh
cc: Philip Selecky, Deputy Clerk

Page 256a Omitted

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. *93-5414* and *94-5048*

INSTRUCTIONAL SYSTEMS, INC.,
a Corporation of the State of New Jersey

v.

COMPUTER CURRICULUM CORPORATION,
a Corporation of the State of Delaware

SUR PETITION FOR REHEARING

Present: SLOVITER, *Chief Judge*, BECKER, STAPLETON, MANSMANN, GREENBERG, HUTCHINSON, SCIRICA, COWEN, NYGAARD, ROTH, LEWIS, McKEE, *Circuit Judges*, and POLLAK,* *District Judge*

The petition for rehearing filed by Appellee Computer Curriculum Corporation in the above-entitled case having been

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* Hon. Louis H. Pollak, United States District Judge, as to panel rehearing only.

submitted to the judges who participated in the decision of this court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied. Judge Becker would grant rehearing in banc.

By the Court,

/s/ D. Sloviter
Chief Judge

Dated: Nov. 3, 1994

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. *93-5722*

INSTRUCTIONAL SYSTEMS, INC.,
a Corporation of the State of New Jersey

v.

COMPUTER CURRICULUM CORPORATION,
a Corporation of the State of Delaware

SUR PETITION FOR REHEARING

Present: SLOVITER, *Chief Judge*, ROTH, *Circuit Judge*, and POLLAK, *District Judge*

The petition for rehearing filed by Appellant Instructional Systems, Inc. in the above-entitled case having been submitted to the judges who participated in the decision of this court, and no

judge who concurred in the decision having asked for rehearing, the petition for rehearing is denied.

By the Court,

/s/ D. Sloviter
Chief Judge

Dated: Nov. 3, 1994

CHAPTER 10

FRANCHISES

A. Franchise Practices Act

56:10-1. Short title

This act shall be known and may be cited as the "Franchise Practices Act."

L.1971, c.356, § 1, eff. Dec. 21, 1971

56:10-2. Legislative findings

The Legislature finds and declares that distribution and sales through franchise arrangements in the State of New Jersey vitally affects the general economy of the State, the public interest and the public welfare. It is therefore necessary in the public interest to define the relationship and responsibilities of franchisors and franchisees in connection with franchise arrangements.

L.1971, c.356, § 2, eff. Dec. 21, 1971.

56:10-3. Definitions

As used in this act:

a. "Franchise" means a written arrangement for a definite or indefinite period, in which a person grants to another person a license to use a trade name, trade mark, service mark, or related characteristics, and in which there is a community of interest in the marketing of goods or services or wholesale, retail, by lease, agreement, or otherwise.

b. "Person" means a natural person, corporation, partnership, trust, or other entity and, in case of an entity, it shall

include any other entity which has a majority interest in such entity or effectively controls such other entity as well as the individual officers, directors, and other persons in active control of the activities of each such entity.

c. "Franchisor" means a person who grants a franchise to another person.

d. "Franchisee" means a person to whom a franchise is offered or granted.

e. "Sale, transfer or assignment" means any disposition of a franchise or any interest therein, with or without consideration, to include but not limited to bequest, inheritance, gift, exchange, lease or license.

f. "Place of business" means a fixed geographical location at which the franchisee displays for sale and sells the franchisor's goods or offers for sale and sells the franchisor's services. Place of business shall not mean an office, a warehouse, a place of storage, a residence or a vehicle.

L.1971, c.356, § 3, eff. Dec. 21, 1971

56:10-4. Franchises to which act applicable

This act applies only:

a. to a franchise (1) the performance of which contemplates or requires the franchisee to establish or maintain a place of business within the State of New Jersey, (2) where gross sales of products or services between the franchisor and franchisee covered by such franchise shall have exceeded $35,000.00 for the 12 months next preceding the institution of suit pursuant to this act, and (3) where more than 20% of the franchisee's gross sales are intended to be or are derived from such franchise.

b. to a franchise for the sale of new motor vehicles as defined in R.S.39:10-2, the performance of which contemplates or

requires the franchisee to establish or maintain a place of business within the state of New Jersey.

L.1971, c.356, § 4, eff. Dec. 21, 1971; amended by L.1993, c.189, § 1, eff. July 19, 1998.

56:10-5. Termination of franchise; notice; grounds

It shall be a violation of this act for any franchisor directly or indirectly through any officer, agent, or employee to terminate, cancel, or fail to renew a franchise without having first given written notice setting forth all the reasons for such termination, cancellation, or intent not to renew to the franchisee at least 60 days in advance of such termination, cancellation, or failure to renew, except (1) where the alleged grounds are voluntary abandonment by the franchisee of the franchise relationship in which event the aforementioned written notice may be given 15 days in advance of such termination, cancellation, or failure to renew; and (2) where the alleged grounds are the conviction of the franchisee in a court of competent jurisdiction of an indictable offense directly related to the business conducted pursuant to the franchise in which event the aforementioned termination, cancellation or failure to renew may be effective immediately upon the delivery and receipt of written notice of same at any time following the aforementioned conviction. It shall be a violation of this act for a franchisor to terminate, cancel or fail to renew a franchise without good cause. For the purposes of this act, good cause for terminating, cancelling, or failing to renew a franchise shall be limited to failure by the franchisee to substantially comply with those requirements imposed upon him by the franchise.

L.1971, c.356, § 5, eff. Dec. 21, 1971.

56:10-6. Transfer of franchise; notice; approval; agreement of compliance

It shall be a violation of this act for any franchisee to transfer, assign or sell a franchise or interest therein to another

person unless the franchisee shall first notify the franchisor of such intention by written notice setting forth in the notice of intent the prospective transferee's name, address, statement of financial qualification and business experience during the previous 5 years. The franchisor shall within 60 days after receipt of such notice either approve in writing to the franchisee such sale to proposed transferee or by setting forth material reasons relating to the character, financial ability or business experience of the proposed transferee. If the franchisor does not reply within the specified 60 days, his approval is deemed granted. No such transfer, assignment or sale hereunder shall be valid unless the transferee agrees in writing to comply with all the requirements of the franchise then in effect.

L.1971, c.356, § 6, eff. Dec. 21, 1971.

56:10-7. Prohibited practices

It shall be a violation of this Act for any franchisor, directly or indirectly, through any officer, agent or employee, to engage in any of the following practices:

a. To require a franchisee at time of entering into a franchise arrangement to assent to a release, assignment, novation, waiver or estoppel which would relieve any person from liability imposed by this act.

b. To prohibit directly or indirectly the right of free association among franchisees for any lawful purpose.

c. To require or prohibit any change in management of any franchisee unless such requirement or prohibition of change shall be for good cause, which cause shall be stated in writing by the franchisor.

d. To restrict the sale of any equity or debenture issue or the transfer of any securities of a franchise or in any way prevent or attempt to prevent the transfer, sale or issuance of shares of stock or debentures to employees, personnel of the

franchisee, or heir of the principal owner, as long as basic financial requirements of the franchisor are complied with, and provided any such sale, transfer or issuance does not have the effect of accomplishing a sale of the franchise.

e. To impose unreasonable standards of performance upon a franchisee.

f. To provide any term or condition in any lease or other agreement ancillary or collateral to a franchise, which term or condition directly or indirectly violates this act.

L.1971, c.356, § 7, eff. Dec. 21, 1971.

56:10-8. Application of act to prior grants of franchises

This act shall not apply to a franchise granted prior to the effective date of this act, provided, however, that a renewal of a franchise or an amendment to an existing franchise shall not be excluded from the application of this act.

L.1971, c.356, § 8, eff. Dec. 21, 1971.

56:10-9. Action against franchisor; defenses

It shall be a defense for a franchisor, to any action bright under this act by a franchisee, if it be shown that said franchisee has failed to substantially comply with requirements imposed by the franchise and other agreements ancillary or collateral thereto.

56:10-10. Action against franchisor; damages; injunction; costs

Any franchisee may bring an action against its franchisor for violation of this act in the Superior Court of the State of New Jersey to recover damages sustained by reason of any violation of this act and, where appropriate, shall be entitled to injunctive relief. Such franchisee, if successful, shall also be entitled to the

costs of the action including but not limited to reasonable attorney's fees.

L.1971, c.356, § 10, eff. Dec. 21, 1971.

56:10-11. Severability

If any provision of this law or the application thereof to any person or circumstance is held invalid, the invalidity shall not affect other provisions or applications of the law which can be given effect without the invalid provision or application, and to this end the provisions of this law are severable.

L.1971, c.356, § 11, eff. Dec. 21, 1971.

No. 94-1033

JAN 9 1995

IN THE

Supreme Court of the United States

OCTOBER TERM, 1994

COMPUTER CURRICULUM CORPORATION,

Petitioner,

—v.—

INSTRUCTIONAL SYSTEMS, INC., and DEBORAH T. PORITZ, ATTORNEY GENERAL OF THE STATE OF NEW JERSEY,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI AND APPENDIX

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QUESTIONS PRESENTED

1. Did the Court of Appeals err in holding that 28 U.S.C. § 1738 and 28 U.S.C. § 1652 required that preclusive effect be given to a final judgment of the New Jersey Supreme Court holding that New Jersey law governed the relationship between the parties and that the relationship was a franchise?

2. Did the Court of Appeals err in holding that the territorial and exclusivity provisions of the franchise were not mandated by New Jersey law but were the consequence of the parties volitional action in specifying these terms in the franchise agreement?

3. Did the Court of Appeals err in holding that neither it nor the New Jersey Supreme Court had before it evidence relating to termination under the applicable provisions of the Franchise Practices Act and could not, therefore, determine on this record whether those facts were sufficient to raise Constitutional issues under the Commerce Clause?

PARTIES TO THE PROCEEDINGS AND RULE 29.1 STATEMENT

Respondent Instructional Systems, Inc. ("ISI"), the plaintiff, is a New Jersey Corporation the stock of which is not publicly traded. Respondent Attorney General of the State of New Jersey intervened to resist a challenge by Petitioner Computer Curriculum Corporation ("CCC") to the constitutionality of the New Jersey Franchise Practices Act. CCC is a wholly-owned subsidiary of Simon & Schuster, Inc., which in turn is a wholly-owned subsidiary of Paramount, Inc., which was recently acquired by Viacom, Inc.

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CONSTITUTIONAL AND STATUTORY PROVISIONS

In addition to the Constitutional and statutory provisions set forth in CCC's Petition for Writ of Certiorari:

The Rules of Decision Act provides:

> The laws of the several states, except when the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply. 28 U.S.C. § 1652.

The Full Faith and Credit Act provides:

> . . . [a]cts, records and judicial proceedings . . . [of State courts] shall have the same full faith and credit in every court within the United States . . . as they have by law or usage in the courts of such State . . . from which they are taken. 28 U.S.C. § 1738, cl. 3.

The New Jersey Franchise Practices Act provides:

> This [Franchise Practices] Act shall not apply to a franchise granted prior to the effective date of this Act, provided, however, that a renewal of a franchise or an amendment to an existing franchise shall not be excluded from the application of this Act. N.J.S.A. 56:10-8.

STATEMENT OF THE CASE

In 1971 the New Jersey Legislature, codifying some features of New Jersey's common law,[1] enacted the Franchise Practices Act ("NJFPA"). L. 1971 c 356 §§ 1-12, eff. Dec. 21, 1971. The NJFPA defines a franchise as "a written arrange-

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[1] *See Shell Oil Co. v. Marinello*, 63 N.J. 402, 409, 307 A.2d 599 (1973), *cert. denied*, 415 U.S. 920 (1974); *Westfield Center Service v. Cities Serv. Oil*, 86 N.J. 453, 462-63, 432 A.2d 48 (1981).

ment for a definite or indefinite period, in which a person grants to another person a license to use a trade name, trade mark, service mark, or related characteristics, and in which there is a community of interest in the marketing of goods or services at wholesale, retail, by lease, agreement, or otherwise." N.J.S.A. 56:10-3(a). The NJFPA applies only to a franchise "the performance of which contemplates or requires the franchisee to establish or maintain a place of business within the State of New Jersey." N.J.S.A. 56:10-4. Moreover, it applies only if more than twenty percent of the franchisee's gross sales are derived from the franchise. *Id.* The NJFPA requires a sixty-day written notice of the termination, cancellation, or failure to renew a franchise, setting forth the reasons for any such action.[2] N.J.S.A. 56:10-5. The NJFPA also provides:

> It shall be a violation of this act for a franchisor to terminate, cancel or fail to renew a franchise without good cause.

Id. Good cause is "limited to failure by the franchisee to substantially comply with those requirements imposed upon him by the franchise." *Id.*

Neither the NJFPA nor any other provision of New Jersey law requires a franchisor to grant to a franchisee the right to distribute goods or services in a defined territory. Neither the NJFPA nor any other provision of New Jersey law requires a franchisor to grant to a franchisee any exclusive distribution rights. As was the case prior to the enactment of the NJFPA, distribution territory and distribution exclusivity are matters left by New Jersey law entirely to party choice at the time the franchise contract is negotiated.

In 1984, more than a dozen years after the effective date of the NJFPA, CCC and ISI entered into the contract that is the

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[2] The Act imposes on franchisees a notice of transfer obligation. N.J.S.A. 56:10-6.

subject of the instant lawsuit.[3] That agreement gave ISI the exclusive right to distribute CCC products in New Jersey, nine other states, and the District of Columbia. The NJFPA had no impact on the exclusivity or territoriality features of the parties' agreement. Those features were chosen, after the effective date of the NJFPA, by the parties in negotiations entirely unconstrained by New Jersey law respecting exclusivity or territory. Moreover, even the termination provisions of the NJFPA could have been avoided simply by not entering into a franchise contract after the effective date of that Act. N.J.S.A. 56:10-8.

In 1989, CCC, without giving the notice required by N.J.S.A. 56:10-5, failed to renew the 1984 agreement. CCC unilaterally tendered to ISI a different contract in which ISI's territory was reduced to three states: New Jersey, New York and Massachusetts. ISI signed the 1989 contract under protest and promptly filed this lawsuit. The suit was filed in the Superior Court of New Jersey, as expressly authorized by the NJFPA.[4]

CCC removed the action to the United States District Court on the basis of diversity of citizenship. 28 U.S.C. § 1441(a). When ISI moved before the District Court for a preliminary injunction, CCC urged: (1) that California law, not New Jersey law, applied to the agreement; (2) that the 1984 contract was not a franchise as defined by the NJFPA; and (3) that CCC's termination did not violate the NJFPA. CCC also urged: that if its actions violated the NJFPA the application of

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[3] Although this lawsuit involves the 1984 contract, the New Jersey trial court found as a fact that the franchise relationship was first formed in a 1980 contract. RA 2.

[4] "Any franchisee may bring an action against its franchisor for violation of this act in the Superior Court of the State of New Jersey to recover damages sustained by reason of any violation of this act and, where appropriate, shall be entitled to injunctive relief." N.J.S.A. 56:10-10.

the statute to a franchise territory outside New Jersey violated the dormant Commerce Clause. CCC has never contended that the NJFPA is inconsistent with any federal legislation.

The District Court declined to decide ISI's motion for a preliminary injunction and entered an order remitting to the Superior Court of New Jersey the state law issues raised by CCC. RA 16. The District Court action was "administratively stayed and terminated" pending a final judgment in the New Jersey state courts. RA 16.

Pursuant to the District Court's order, ISI promptly filed suit in the New Jersey Superior Court, Chancery Division, for declaratory relief. On cross-motions for summary judgment the trial court entered a declaratory judgment in ISI's favor, holding: (1) that New Jersey law, not California law, applied to the 1984 agreement; (2) that the 1984 agreement was a franchise; and (3) that the franchise territory, defined by the parties, included ten states and the District of Columbia. That declaratory judgment also states:

> The Court has stated that the Legislature did not intend the law of New Jersey to have extraterritorial effect. ISI and CCC in the contract, which is the franchise, defined a market area which includes states beyond the State of New Jersey. The Legislature intended the Act to apply to New Jersey franchises and the rights thereunder whether or not the market area is beyond New Jersey. To the extent that the laws of other states apply by reason of activities of the parties and the terms of those laws, they would apply.

RA 3. The trial court's finding that the parties—not New Jersey law—determined the franchisee's market area is consistent with N.J.S.A. 56:10-8.

The Appellate Division of the Superior Court reversed the trial court's finding that the 1984 contract was a franchise under the NJFPA. *See Instructional Systems, Inc. v. Computer*

Curriculum Corp., 243 N.J. Super. 53, 578 A.2d 876 (App. Div. 1990). The New Jersey Supreme Court reversed, and reinstated the judgment of the Chancery Division. *See Instructional Systems, Inc. v. Computer Curriculum Corp.*, 130 N.J. 324, 614 A.2d 124 (1992). The Supreme Court of New Jersey held:

(1) That the trial court did not err in finding as a fact that the relationship between the parties, as set forth in the 1984 contract, is a franchise under the NJFPA. *Id.* at 347-66.

(2) That the trial court did not err in holding that despite the choice of law clause in the 1984 contract, New Jersey law governs the relationship between the parties because "New Jersey had the overriding interest in the fair treatment of its franchisees." *Id.* at 341-46.

The New Jersey Supreme Court further noted affirmatively that the trial court "qualified its interpretation of New Jersey law to the extent that it actually conflicted with the law of sister states." *Id.* at 346.

Rejecting the very argument made in CCC's Petition for Certiorari, the New Jersey Supreme Court observed that were the argument to be accepted:

> . . . nearly every aspect of substantive state law would be disabled from affecting the conduct of multi-state corporations. When New Jersey law imposes a legal duty on the volitional behavior of a contracting party, that ruling will often have effects beyond state boundaries. For example, if the issue were one of straight contract law, *i.e.*, had the contract precluded termination of the out-of-state territory, the New Jersey common law upholding the contract would be regulating commerce that takes place wholly outside of the state's borders. In terms of state power, whether state contract law or state statutory

> law is applied to the in-state activity makes no difference.

Id. at 369.

Thus, both the New Jersey trial court and the New Jersey Supreme Court focused upon the indisputable fact that the parties' volitional action, not state law, resulted in a franchise agreement with a New Jersey franchisee granting an exclusive territory; issues of exclusivity and territory as to which New Jersey law, prior to that volitional action, was indifferent.

The final judgment of the highest state court of New Jersey (assuming it decided a federal question) was reviewable in the United States Supreme Court and no other. 28 U.S.C. § 1257; 28 U.S.C. § 1738; *Rooker v. Fidelity Trust Co.*, 263 U.S. 413 (1923); *District of Columbia Court of Appeals v. Feldman*, 460 U.S. 462 (1983). CCC did not seek such review.

When the parties returned to the District Court, CCC made the argument that it tenders in its Petition for Certiorari, namely, that it was not volitional party action that determined exclusivity and territory, but rather the NJFPA. The District Court fell for this fallacious argument. *See Instructional Systems, Inc. v. Computer Curriculum Corp.*, 826 F. Supp. 831 (D. N.J. 1993). The Court of Appeals did not. *See Instructional Systems, Inc. v. Computer Curriculum Corp.*, 35 F.3d 813 (3d Cir. 1994). The Court of Appeals opinion acknowledged the binding effect of the New Jersey judgment on state choice of law rules, on state law, and on the facts with respect to the existence of a New Jersey franchise relationship voluntarily undertaken by the parties. *Id.* at 823. That Court held that "the judgment the parties received from the New Jersey courts on the state law claims binds them." *Id.*

REASONS FOR DENYING THE WRIT

I. THE "QUESTIONS PRESENTED" IN CCC'S PETITION FOR CERTIORARI ARE NOT PRESENTED IN THE RECORD IN THE COURT OF APPEALS.

The Court should not grant CCC's hyperbolic and deceiving petition "in the mistaken belief that the issues presented can be decided." Supreme Court Rule 15.1. The questions CCC purports to present were not presented by the summary judgment record in the District Court. The Court of Appeals recognized that they were not and properly decided, instead, the questions set forth at the front of this brief.

A. The Court of Appeals Decision Does Not Conflict With This Court's *Healy* and *Brown-Forman* Decisions

In the District Court CCC, in a slick piece of misdirection which relies on a false premise, constructed a superficially logical syllogism that misled that Court into granting summary judgment against ISI. The syllogism proceeds thus:

Major Premise:

> New Jersey law cannot directly regulate commerce in other states. *Healy v. Beer Institute, Inc.*, 491 U.S. 324 (1989); *Brown-Forman Distillers Corp. v. New York State Liquor Authority*, 476 U.S. 573 (1986).

Minor Premise:

> New Jersey law directly regulates commerce in other states by requiring that ISI's exclusive territorial franchise be terminated only in accordance with the terms of the New Jersey Franchise Practices Act, N.J.S.A. 56:10-5.

Conclusion:

> Therefore, N.J.S.A. 56:10-5 is unconstitutional.

The District Court failed to recognize that the syllogism contained a false minor premise. New Jersey has *no* policy respecting either the territorial extent or the exclusivity of franchises. Both matters are left entirely to the agreement of the parties.

The Court of Appeals did not fall for CCC's misdirection. As Chief Judge Sloviter correctly observed:

> In this case the record is clear that it was the parties, not New Jersey, who contemplated that the franchisee maintain a place of business in New Jersey. And it was the parties, not New Jersey, who bound themselves to an exclusive multistate distribution agreement. Therefore it was the parties' own agreement which operated to project the New Jersey law outside of New Jersey's borders, a result which CCC will find ironic but which inevitably follows from the choice-of-law analysis.

Instructional Systems, Inc. v. Computer Curriculum Corp., 35 F.3d at 825. Chief Judge Sloviter's reasoning is sound. The NJFPA, like the common law before it, is concerned with the fairness of the contractual terms, not with the regulation of commerce. The requirement that a franchise may not be terminated except for good cause applies equally to a single intrastate location or many locations in many states. Conceptually, it is no different from other fairness provisions developed by the common law and often embodied in statutory codifications, such as the Uniform Commercial Code. Contracts governed by such provisions usually involve interstate commerce. Contracts of adhesion, for example, often do. And the requirements of good faith and fair dealing are not confined to intrastate business. CCC would have the Court focus exclusively upon the geographic scope of the franchise business, not the franchise contract itself. But it is a single

contract and a single state law governs its fairness and performance. CCC argues that it never agreed to be bound by New Jersey law. But if New Jersey law is the proper law of the contract, CCC did agree as a matter of law. It cannot now be heard to plead ignorance of the consequences of what it did. The applicability of New Jersey law has already been finally adjudicated.

Thus *Healy* and *Brown-Forman*, on which CCC bases its dormant Commerce Clause argument are simply not in point. Those cases were not concerned with contractual fairness but with state regulation of prices to protect local consumers. To illustrate that crucial difference, let us hypothesize that the brewers in *Healy* or the distillers in *Brown-Forman* had voluntarily contracted with a distributor in State A that they would afford that distributor prices and terms no less favorable than those charged to distributors in adjoining states B and C. Surely, CCC's attorneys would not with a straight face advance the proposition that *Healy* or *Brown-Forman* required invalidating the brewers' or distillers' voluntarily assumed contractual undertakings. Yet enforcing the parties' contract in accordance with State A's contract law would have an economic effect essentially the same as the effect of the state price-posting statutes struck down in those cases.[5] As Judge Sloviter correctly observes:

> However, in [*Healy* and *Brown-Forman*] it was the state, operating independently of any parties' contract, which dictated the extraterritorial effect.

Instructional Systems, Inc. v. Computer Curriculum Corp., 35 F.3d at 825-26. Absent such state independent action, the Commerce Clause has no application. The Court's dormant Commerce Clause jurisprudence relates to the allocation between the states and the national government of political power to regulate commerce, not to private decision making.

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[5] This point was made in Justice O'Hern's Opinion for the Supreme Court of New Jersey, quoted at p. 5, *supra*.

Similar misdirection is attempted in CCC's argument, Petition, 20, predicated upon *Western & Southern L.I. Co. v. Calif. Board of Equalization*, 451 U.S. 648, 664 (1981). That case articulates the proposition that a state may not impose as a condition for doing business in the state the relinquishment of constitutional rights. New Jersey imposed *no* condition on CCC's doing business in New Jersey. It did not say that CCC had to do business with a New Jersey franchisee. It did not say that a franchise with a New Jersey franchisee had to be exclusive. It did not say that the franchise had to be for a multistate territory, or indeed any specific territory. The only condition imposed was that if CCC entered into a franchise contract with a franchisee having a place of business in New Jersey, that contract could be terminated only in compliance with the NJFPA. All else was a matter of negotiation and party action.

B. The Court of Appeals Employed Well Established Rules of Law, Not "Legal Fictions".

In a futile effort to avoid Chief Judge Sloviter's solid Commerce Clause analysis, CCC's Petition for Certiorari urges that the Court of Appeals employed "*LEGAL FICTIONS [THAT] WOULD SERIOUSLY ERODE THE PROTECTIONS OF THE COMMERCE CLAUSE.*" Petition, 17.

The CCC argument is disingenuous. It assumes, contrary to the facts, that the California choice of law provision and the five-year term set forth in the 1984 agreement are binding upon the parties. That simply is not so. The Supreme Court of New Jersey, in a judgment that is final and unreviewable, held: (1) that CCC had voluntarily entered into a franchise contract with a franchisee located in that state; (2) that despite the choice of law provision in the contract, New Jersey choice of law rules required the application of New Jersey law to that relationship; and (3) that despite the five-year term set forth in the contract, New Jersey law determined how that relationship may be terminated. *Instructional Systems,*

Inc. v. Computer Curriculum Corporation, 130 N.J. 324, 614 A.2d 124 (1992). As Chief Judge Sloviter aptly puts it, "the essence of-CCC's objection, despite its assurance to the contrary, goes to New Jersey's decision on choice of law." *Instructional Systems, Inc. v. Computer Curriculum Corp.*, 35 F.3d at 826.

The Court of Appeals opinion acknowledges what the CCC Petition for Certiorari fails to address; namely, the binding effect of the New Jersey judgment on state choice of law rules, on state law and on the facts with respect to the existence of a New Jersey franchise relationship voluntarily undertaken by the parties. *Id.* at 823. *See* 28 U.S.C. § 1652; *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487 (1941) (state choice of law rules must be followed in a diversity case); *Electrical and Magneto Service v. Amtac Intern.*, 941 F.2d 660 (8th Cir. 1991) (franchisor cannot avoid application of forum's choice of law rule by inserting a choice of law clause in a franchise agreement); 28 U.S.C. § 1738; *Migra v. Warren County School Dist. Bd. of Ed.*, 465 U.S. 75, 84 (1984); *Allen v. McCurry*, 449 U.S. 90, 99 (1980) (federal court is bound to extend same preclusive effect to state court judgment as courts of rendering state would); *District of Columbia Court of Appeals v. Feldman, 460 U.S. 462 (1983); Rooker v. Fidelity Trust Co., 263 U.S. 413 (1923)*; *Port Auth. Police Benevolent v. Port Auth. of N.Y. and N.J.*, 973 F.2d 169, 177 (3d Cir. 1992) (under *Rooker-Feldman* doctrine lower federal courts lack subject matter jurisdiction to engage in appellate review of state court determinations even if those determinations are intertwined with federal constitutional claims). Neither 28 U.S.C § 1652 nor 28 U.S.C. § 1738 nor the jurisdictional provisions of Title 28 that are the source of the *Rooker-Feldman* doctrine are "Legal Fictions." They are rules of law which bound the District Court and the Court of Appeals, and controlling authority for this Court as well.

The Court of Appeals' holding that "the judgment the parties received from the New Jersey courts on the state law

claims binds them," *Instructional Systems, Inc. v. Computer Curriculum Corp.*, 35 F.3d at 823, is unassailable. Recognizing as much, CCC's Petition for Certiorari conveniently ignores that insurmountable obstacle. CCC hopes that its false assertion that the contractual choice of law clause and the contractual five-year term clause bind the parties will mislead members of this Court as that same false assertion misled the District Court.

No amount of smoke and mirror advocacy can change the facts that after the enactment of the NJFPA, CCC voluntarily entered into a New Jersey franchise contract; that CCC voluntarily made that relationship exclusive, although New Jersey law did not require exclusivity; and that CCC voluntarily defined the franchise territory to cover eleven jurisdictions, although New Jersey law says nothing about franchise territories. The Court of Appeals' holding that it was the parties, not the State of New Jersey, that did any "projection" is solidly grounded on these unassailable facts. Thus there is no conceivable conflict with the *Healy* and *Brown-Forman* cases on which CCC relies.

C. There is No Record Evidence of a *Pike v. Bruce Church* Violation.

CCC's criticism of the Court of Appeals' treatment of the balancing test of *Pike v. Bruce Church*, 397 U.S. 137 (1970), Petition, 24, is also factually and logically flawed. The *Pike* rule is that a state law that does not discriminate against out-of state participants in interstate commerce but nevertheless places some burden on such commerce "will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." *Id.* at 142. The NJFPA applies evenhandedly to in-state and out-of-state franchisors. Thus any burden applies equally to all franchisors. Moreover, the NJFPA is prospective only, and even prospectively does not limit the contractual undertakings of franchisors except with respect to termination or non-renewal. Thus the narrow

issue tendered by CCC in Point III of its Petition is whether New Jersey regulation of the termination or non-renewal of all New Jersey franchises imposes an undue burden despite New Jersey's obvious interest in such franchises.

The case was before the Court of Appeals on a summary judgment record. Because CCC urged, both in the New Jersey Courts and in the District Court, that the NJFPA was a *per se* violation of the Commerce Clause, no evidence was tendered by CCC in support of the summary judgment motion with respect to the extent of the burden on interstate commerce resulting from the termination and non-renewal provisions of that Act. Since none was tendered there was no occasion for ISI to offer contrary evidence. As the Court of Appeals pointed out, any such evidence, if it exists, might have to await the interpretation given to "good cause" under the NJFPA termination provision. *Instructional Systems, Inc. v. Computer Curriculum Corp.*, 35 F.3d at 827. Since in 1989 no proper notice of termination was given, and failure to give such notice, standing alone, is a violation of the NJFPA, such evidence even if tendered will be excluded as irrelevant. Thus this Court could not, consistent with due process, undertake on the present record to adjudicate a *Pike* balancing issue. Moreover, it is unlikely in this case ever to be presented with a record containing a *Pike* balancing issue.

What *is* established by the present record is that the State of New Jersey had a sufficient interest in the relationship between the parties so that its law should apply to that relationship; that the relationship was voluntarily created after the effective date of the NJFPA; that New Jersey does not require anyone to distribute goods and services through a franchisee; and that New Jersey law requires neither a defined franchise territory nor exclusivity. Thus the *Pike* contention comes down to this: the termination or non-renewal provisions in the NJFPA, standing alone, impose a burden on all voluntarily undertaken relationships such that "the burden imposed on interstate commerce is clearly excessive in relation to the

putative local benefits." *Pike v. Bruce Church*, 397 U.S. at 142.

The putative local benefits are clearly identified in opinions of the New Jersey Supreme Court. In *Shell Oil Co. v. Marinello*, 63 N.J. 402 (1973), *cert. denied*, 415 U.S. 920 (1974), the Court noted that there was grossly disproportionate bargaining power between franchisors and franchisees, and held that in such a situation it would declare as void against public policy contractual provisions that would result in the forfeiture of a franchisee's investment. When it enacted the NJFPA, New Jersey in effect codified its common law contract rule.

> Prompted in large measure by the unfair practices of automobile manufacturers and major oil companies, New Jersey passed the Franchise Practices Act in 1971. N.J.S.A. 56:10-1 to -12. This Act was supplemented in 1977 with four sections, two of which specifically concern automobile franchises. See N.J.S.A 56:10-7.1 and 56:10-13. In 1982, the Legislature passed the Motor Vehicle Franchises Act, N.J.S.A. 56:10-16 to -25 (now N.J.S.A. 56:10-16 to -29). The Franchise Practices Act (the Act) provides franchisees protection against indiscriminate terminations by prohibiting cancellation or non-renewal of franchises for other than good cause. The Act's supporters indicated that "[t]his bill gives neither the franchisor nor franchisee the upper hand. What it does, however, is to prevent arbitrary or capricious actions by the franchisor who generally has vastly greater economic power than the franchisee." Franchise Practices Act: *Hearing on A. 2063 Before the Assembly Judiciary Comm.*, 194th Leg., 2d Sess. 136 (1971) (Hearing on A. 2063) (Statement of Charles W. Davis, Executive Vice-President New Jersey Hotel/Motel Ass'n).

Instructional Systems, Inc. v. Computer Curriculum Corporation, 130 N.J. at 340-41. *See also Westfield Center Service*

v. Cities Serv. Oil, 86 N.J. 453, 462-63, 432 A.2d 48 (1981). New Jersey has thus clearly identified a highly significant local benefit from the NJFPA termination provisions.

All that the record discloses with respect to burden on interstate commerce, however, is that CCC is offended at having lost its case on the existence of the franchise relationship and on New Jersey choice of law. Because those issues are foreclosed, 28 U.S.C. § 1738; 28 U.S.C. § 1652, CCC insists with great heat but no light that catastrophic consequences to the free flow of interstate commerce will result from the NJFPA provisions. The only record evidence is that one contracting franchisor, CCC, must continue doing business with one New Jersey franchisee, ISI, so long as ISI does not materially breach the franchise agreement. There is no evidence establishing that even CCC's own interstate commerce has been reduced or inhibited. There is simply nothing of record for the Court to balance on the burden on interstate commerce side of the *Pike* equation.

While we do not believe it will be possible even after trial for CCC to present facts which could invoke a *Pike* excessive burden issue, it is clear that no such facts were before the New Jersey Supreme Court or the Court of Appeals. It will be time enough for this Court to address the hypothetical questions suggested by CCC, Petition, 24, when and if relevant facts exist in the record on appeal.

II. THIS CASE HAS NO SIGNIFICANCE TO ANYONE EXCEPT ISI AND CCC, AND THERE IS NO REASON FOR GRANTING CERTIORARI.

CCC's Petition is replete with overblown rhetoric to the effect that the Court of Appeals decision "would permit individual states . . . to usurp Congress' exclusive power to regulate the national economy," Petition, 9, "threatens every manufacturer, in every sector of the economy," Petition, 15, and permits New Jersey to impose restrictions on distribution

methods that Congress has rejected. Petition, 12, 13. Despite the rhetoric, however, there is nothing in the Petition worthy of this Court's attention.

A. The NJFPA is Consistent With Federal Franchise Legislation and Leaves Congressional Commerce Clause Power to Regulate the National Economy Unimpaired.

Congress obviously could preempt state legislation on franchising or on any other subject affecting interstate commerce. Indeed, although CCC's Petition misleadingly suggests otherwise, Congress has in fact legislated on the subject of franchising in interstate commerce. In the Automobile Dealer's Day-In-Court Act, Pub. L. 1026, ch. 1038, Aug. 8, 1956, 70 Stat. 1125, 15 U.S.C. § 1221 *et seq.*, it dealt comprehensively with the same issues of inequality of bargaining power in the automobile industry that the NJFPA addresses more generically. Section 2 of that Act, 15 U.S.C. § 1222, imposes an obligation on automobile manufacturers "to act in good faith in performing or complying with the terms or provisions of the franchise, or in terminating, cancelling, or not renewing the franchise with said dealer." This language is the source of the language on termination in the NJFPA. Significantly, that seminal federal franchise protection legislation expressly preserved a role for state law, providing that

> "[t]his chapter shall not invalidate any provision of the laws of any State except insofar as there is a direct conflict between an express provision in this Chapter and an express provision of State law which can not be reconciled."

15 U.S.C. § 1225. As the Supreme Court of New Jersey notes in *Instructional Systems, Inc. v. Computer Curriculum Corp.*, 130 N.J. at 340, the NJFPA was amended in 1977 to deal more specifically with automobile industry franchising. N.J.S.A. 56:10-16 to -29. That legislation is authorized by 15 U.S.C. § 1225.

More recently in the Petroleum Marketing Practices Act, Congress addressed the protection of franchisees in the distribution of petroleum products. Pub. L.95-297, Title 1, June 19, 1978, 92 Stat. 322, 15 U.S.C. § 2801 *et seq.* The Petroleum Marketing Practices Act deals comprehensively with both termination and non-renewal of franchises, carefully circumscribing the power of franchisors in the petroleum industry to do either. 15 U.S.C. § 2802, 2804. In contrast with the Automobile Dealers Day-In-Court Act, however, Congress dealt with the preemption of state law somewhat more restrictively:

> To the extent that any provision of this subchapter applies to the termination (or the furnishing of notification with respect thereto) of any franchise, or to the non-renewal (or the furnishing of notification with respect thereto) of any franchise relationship, no State or any political subdivision thereof may adopt, enforce, or continue in effect any provision of any law or regulation (including any remedy or penalty applicable to any violation thereof) with respect to termination (or the furnishing of notification with respect thereto) of any such franchise or to the non-renewal (or the furnishing of notification with respect thereto) of any such franchise relationship unless such provision of such law or regulation is the same as the applicable provision of this subchapter.

15 U.S.C. § 2806(a). Congress thus permits state law protection of franchisees against termination and non-renewal in the petroleum industry so long as the state law is "the same as" the federal law.

In two of the largest segments of the national economy therefore—the automobile and the petroleum industries—Congress has adopted franchise protection measures that are parallel to those in the more generic NJFPA. Moreover in neither instance did Congress restrict application of those pro-

tection measures to single state, rather than multi-state, franchises. It would be fanciful in the extreme for this Court to hold that the application of the NJFPA termination and nonrenewal provisions imposed an undue burden on interstate commerce in industries other than automobile and petroleum distribution when Congress has decided that such protections are *required* for the facilitation of interstate commerce in two of the largest segments of the national economy.

More significantly, the Automobile Dealers Day-In-Court Act and the Petroleum Marketing Practices Act demonstrate that Congress is perfectly aware of the disparity of bargaining power issue, addressed by New Jersey common law in *Shell Oil Co. v. Marinello*, *supra*, and by statute in the NJFPA. Congress is, moreover, perfectly capable of deciding for itself when and to what extent state law should be preempted. Even in those areas of the economy where Congress has chosen to legislate on franchise practices it has carefully preserved some role for state law. The NJFPA is a part of New Jersey's contract law; an area of the law that has traditionally been a matter for state regulation. In such areas of traditional state responsibility the presumption is that Congress intended to leave state law in place except to the extent that it has been expressly displaced.[6]

CCC's Petition thus presents no Commerce Clause policy issues that this Court ought to address. This Court has more serious business requiring its attention.

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[6] *See, e.g., Cipollone v. Liggett Group, Inc.*, 112 S. Ct. 2608, 120 L.Ed. 2d 407, 426-27 (1992); *Goodyear Atomic Corp. v. Miller*, 486 U.S. 174, 184 (1988); *English v. General Electric Co.*, 496 U.S. 72, 85 (1990); *Silkwood v. Kerr-McGee Corp.*, 464 U.S. 238, 256 (1984); *Farmer v. United Brotherhood of Carpenters & Joiners of America, Local 25*, 430 U.S. 290, 304 (1977); *Florida Lime and Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 144 (1963); *Huron Portland Cement Co. v. Detroit*, 362 U.S. 440, 447-48 (1960).

B. The Case Presents No Significant State Sovereignty Issue.

CCC concedes that the NJFPA does not discriminate against out of state franchisors. Its argument that the NJFPA projects New Jersey law into another state is not supported by the record. *Point IA, supra*. CCC's argument that the NJFPA in some way inhibits the sovereign law making power of neighboring states is answered adequately by the observations of the New Jersey trial judge, that "[t]o the extent that the laws of other states apply by reason of activities of the parties and the terms of those laws, they would apply," RA 3, and by the approval of that observation by the New Jersey Supreme Court. *Instructional Systems, Inc. v. Computer Curriculum Corp.*, 130 N.J. at 346.

What is restrained by the NJFPA is not any sovereign power of another state, but only the actions of a private actor, CCC, with respect to the termination of a contractual relationship voluntarily undertaken, and governed by New Jersey law. The fact of that relationship and the applicability of New Jersey law to it were fully litigated in the New Jersey state courts, and cannot be relitigated in the guise of CCC's assertion of the sovereign interests of other states.

CCC identifies no state law that was violated by the methods of distribution engaged in by the parties pursuant to the 1984 franchise agreement, or that would be violated if the District Court should require that the same methods of distribution be continued. No other state's policy indicates a preference for CCC rather than ISI having exclusive distribution rights, and that is exactly what CCC seeks to accomplish.

CONCLUSION

CCC's Petition presents no question that this Court should address, and no issue that is worthy of its attention. The Petition for Certiorari should be denied.

Respectfully submitted,

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Dated: January 9, 1995

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SUPERIOR COURT OF NEW JERSEY
CHANCERY DIVISION
PASSAIC COUNTY

Docket Nos. C-1133-89E, C-4116-89E

Hon. Arthur C. Dwyer, J.S.C.

CIVIL ACTION

Filed November 2, 1989

INSTRUCTIONAL SYSTEMS, INC.,
a Corporation of the State of New Jersey,

Plaintiff,

—vs.—

COMPUTER CURRICULUM CORPORATION,
a Corporation of the State of Delaware,

Defendant.

ORDER OF FINAL JUDGMENT

THIS MATTER having been opened to the Court on the application of Dunn, Pashman, Sponzilli, Swick & Finnerty, attorneys for Instructional Systems, Inc. ("ISI"), for a declaratory judgment and ancillary relief, with respect to certain of its rights under the New Jersey Franchise Practices Act, *N.J.S.A.* 56:10-1 *et seq.* ("Act") and McCarter & English, counsel for Computer Curriculum Corporation, having filed a cross-motion seeking an Order dismissing the Complaint filed in Docket No. C-4116-89E and each of the parties hav-

ing been afforded the opportunity to take the additional discovery requested by them and this Court having heard the arguments of counsel on behalf of both parties on October 12, 1989 relative to their cross-applications and this Court having made on the record findings of fact and conclusions of law on October 30, 1989, which record is incorporated by reference into this Order, and good cause having been shown;

IT IS on this _____ day of November 1989

ORDERED AND ADJUDGED that the proceedings in Docket No. C-1133-89E and Docket No. C-4116-89E be and are hereby consolidated by the Court on its own motion;

IT IS FURTHER ORDERED AND ADJUDGED that this Court has jurisdiction to enter a Final Judgment in this matter under the Declaratory Judgment Act, *N.J.S.A.* 2A:16-15 *et seq.*;

IT IS FURTHER ORDERED AND ADJUDGED that a Final Judgment be and hereby is entered declaring that:

a) as a matter of law, the Act applies to the Agreements dated October 9, 1980 and July 12, 1984 between CCC and ISI ("Agreements");

b) CCC in the Agreements grants to ISI a "license" as that term is used in the Act;

c) the Agreements and the acts of the parties thereunder create a "community of interest" as the term is used in the Act;

d) ISI has maintained a "place of business" as that term is used in the Act;

e) ISI and CCC "contemplated" at the time the Agreements were executed that ISI would in the performance of the Agreements maintain a "place of business" within the State of New Jersey as those terms are used in *N.J.S.A.* 56:10-4(1);

f) the Agreements constitute "franchises" as that term is used in the Act; and

g) the Court has stated that the Legislature did not intend the law of New Jersey to have extraterritorial effect. ISI and CCC in the contract, which is the franchise, defined a market area which includes states beyond the State of New Jersey. The Legislature intended the Act to apply to New Jersey franchises and the rights thereunder whether or not the market area is beyond New Jersey. To the extent that the laws of other states apply by reason of activities of the parties and the terms of those laws, then they would apply. See *Burger King Corporation v. Rudzewicz*, 471 U.S. 462, 105 S. Ct. 2174, 85 L. Ed. 2d 528 (1985);

IT IS FURTHER ORDERED AND ADJUDGED that CCC's cross-motion for summary judgment is denied in its entirety;

IT IS FURTHER ORDERED AND ADJUDGED that ISI's application to have this Court consider issues encompassed by the First Count of the Complaint in Docket No. C-4116-89E (including whether the Act was violated by the non-renewal of July 12, 1984 Agreement, the appropriate remedy(s) and the award of attorneys' fees and costs), above and beyond those construed by this Court as remitted in the Orders dated July 20 and July 27, 1989 of the Honorable Alfred J. Lechner, Jr., United States District Judge for the District of New Jersey, is denied, based on the construction of the Orders by this Court that jurisdiction over the other issues and relief encompassed in the First Count of the Complaint in Docket No. C-4116-89E have been retained by the United States District Court for the District of New Jersey in the pending federal action (now stayed and administratively terminated);

IT IS FURTHER ORDERED AND ADJUDGED that the Superior Court, Passaic County, Chancery Division, having determined all matters remitted to it by Judge Lechner's Order dated July 27, 1989, the Court enters a Final Judgment declaring the rights as found; and

IT IS FURTHER ORDERED AND ADJUDGED that a copy of this Order be served upon all counsel within 5 days of the date of this Order.

/s/ ARTHUR C. DWYER
Hon. Arthur C. Dwyer, J.S.C.

RA5

NOT FOR PUBLICATION

LETTER-OPINION AND ORDER
ORIGINAL FILED WITH THE CLERK OF THE COURT

20 July 1989

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Re: *Instructional Systems, Inc. v. Computer Curriculum Corporation*
Civil Action No. 89-502

Counsel:

The complaint in this matter was initially filed by Instructional Systems, Inc. ("ISI") in the Superior Court of New Jer-

sey, Chancery Division, Passaic County on January 30, 1989. On February 6, 1989 defendant Computer Curriculum Corporation ("CCC") removed this matter from the Superior Court of New Jersey to the United States District Court for the District of New Jersey. On March 27, 1989 CCC filed its Answer and a Counterclaim.

The Complaint alleges that CCC, by terminating ISI's status as an exclusive distributor of CCC products and services in various states other than New Jersey violated the New Jersey Franchise Practices Act, N.J.S.A. 56:10-1 *et. seq.* (the "Franchise Practices Act"). Complaint, Count One. ISI also sets forth six additional counts alleging breach of agreement, breach of implied covenant of good faith and fair dealing, tortious interference with respect to economic advantage, unfair competition, unjust enrichment and breach of fiduciary relationship. Complaint, Counts Two through Seven. The Answer of CCC generally denies the allegations of the Complaint and sets forth affirmative defenses. CCC also filed a counterclaim which alleges ISI breached the agreement at issue.

Presently pending is the ISI application for preliminary injunctive relief and motion for partial summary judgment with regard to the Franchise Practices Act. CCC has opposed the application for preliminary injunctive relief and motion for partial summary judgment, and has cross-moved for partial summary judgment with regard to the Franchise Practices Act. Neither the Answer nor the Counterclaim of CCC raised a federal question. However, in its Memorandum of Points and Authorities in Opposition to the Application for Preliminary Injunction and Motion for Partial Summary Judgment, CCC charged that "applying the New Jersey Act [Franchise Practices Act] to this [c]ase would be an [u]nconstitututional [r]estraint on [i]nterstate [c]ommerce." CCC's Memorandum at 12. As support for this proposition, CCC cited *Healy v. The Beer Institute, Inc.*, ___ U.S. ___, 57 U.S.L.W. 4748 (June 19, 1989).

Following receipt of ISI's opposition brief to the CCC motion for partial summary judgment and reply brief in sup-

port of its application for preliminary injunction and motion for partial summary judgment. ISI sought and was granted leave to file a supplemental memorandum of law regarding abstention. This filing was effected on July 12, 1989. CCC was given leave to file opposition by July 14, 1989. For the reasons which follow, the application of ISI to have this court abstain and remit several of the issues in this case to the courts of New Jersey, to afford the state courts a fair opportunity to decide those issues, on the grounds of abstention pursuant to *Railroad Comm'n of Texas v. Pullman Co.*, 312 U.S. 496 (1941), is granted.

In addition to alleging that the application of the Franchise Practices Act would be an unconstitutional restraint on interstate commerce as applied to this case, CCC has alleged the following:

> 1. The relationship between CCC and ISI is not a franchise and is not subject to the Franchise Practices Act because (a) ISI has never been required to maintain a place of business in New Jersey, its New Jersey headquarters is not a "place of business" and it was not required to maintain its offices in New Jersey, (b) ISI has no community of interest with CCC in that is has not made substantial CCC-specific investments and (c) ISI is a mere licensee.
>
> 2. CCC has not violated the Franchise Practices Act.

See CCC Memorandum in Opposition to Plaintiff's Application for Preliminary Injunction and Partial Summary Judgment and in Support of its Motion for Partial Summary Judgment at 15-42.

As CCC notes in its Supplemental Memorandum of Law on Abstention:

> [F]ederal courts should abstain only when there is a significantly greater chance that it will err in its interpretation of a state statute than would a state court. Moreover, the Third Circuit has held that difficulty of

> determining state law is not, by itself, a sufficient ground for abstention.

Id. at 8 (citations omitted). In this case, it is not the difficulty of determining state law itself which justifies abstention. Specifically, it is the absence of case law guidance and legislative history which necessitates remitting of the nonconstitutional issues to the New Jersey courts for a fair opportunity to determine them. This point of view was forcefully made in a recent Third Circuit decision.

In *New Jersey American, Inc. v. The Allied Corporation*, 875 F.2d 58 (3d Cir. 1989), Judge Becker had an opportunity to discuss the Franchise Practices Act. In connection with this decision ISI, in its Supplemental Memorandum, states: "Judge Becker's opinion in *New Jersey American* can be seen as a plea for the New Jersey courts to offer more guidance on issues surrounding the interpretation of the Franchise Act." Plaintiff's Supplemental Memorandum of Law Regarding Abstention at 10. Although no specific quotation or page reference to the opinion is offered by ISI, it is assumed the quoted statement from the Supplemental Memorandum refers to at least the following three comments of Judge Becker in the *New Jersey American* opinion:

> No New Jersey case gives us significant guidance and the legislative history is of little help.

875 F.2d at 59.

> Determining the reach of the New Jersey [Franchise Practices] Act is no easy task. The Act's vague "community of interest" language and sparse legislative history make it difficult to determine the scope of the Act.

Id. at 63.

> That approach [referring to how the Circuit dealt with the problem in *New Jersey American*], to some extent, fudges the issue, but in the absence of guidance from the New Jersey courts, we are unable to devise an approach

> that better effectuates what we believe to be the purposes underlying the New Jersey [Franchise Practices] Act.

Id. at 65.

ISI contends that most of the reported cases interpreting the definitional requirements of the Franchise Practices Act are federal decisions and that remitting these issues would give the New Jersey courts a fair opportunity to "flesh out the definitional requirements of 'place of business,' 'community of interest' and 'license.' " Plaintiff's Supplemental Memorandum at 9.

In addition to the issues concerning various aspects of the Franchise Practices Act, ISI contends that remitting them to the state judiciary may well avoid a constitutional issue in this case. It appears the constitutional issue in this matter does not go to the validity of the Franchise Practices Act *per se* but rather concerns the application of the Franchise Practices Act to the facts of this case.

CCC raises a number of arguments in opposition to ISI's position on abstention. CCC suggests it is improper for a plaintiff both to request abstention and seek injunctive relief which calls for a broad interpretation of the state statute in question. CCC declares: "This may be the only case in history in which a party has attempted to defeat federal jurisdiction by admitting that its own interpretation of a state statute raises serious constitutional questions." CCC Supplemental Memorandum at 1. While CCC may be correct that the party requesting abstention generally advocates the more narrow interpretation of the state law. ISI's position on the Franchise Practices Act in no way compromises the propriety of this court's decision to abstain. A federal court's responsibility to abstain when confronted with unsettled questions of state law which potentially raise constitutional issues is not dependent upon the breadth of the statutory construction suggested by either party. Rather "[t]he justification for this power, to be exercised within the indicated limits, lies in regard for the respective competence of the state and federal court systems and for the maintenance of harmonious federal-state relations

in a matter close to the political interests of a State." *Louisiana P. & L. Co. v. Thibodaux*, 360 U.S. 25, 29 (1959).

CCC argues that ISI does not have a franchise, as defined by the Franchise Practices Act, and, as well, the activities of ISI in states other than New Jersey are not protected by the Franchise Practices Act in connection with its agreement with CCC. If the New Jersey courts determine ISI does not fit within the definitional requirements of a franchise or that the Franchise Practices Act is inapplicable to States other than New Jersey, the need to address the commerce clause question in this matter will be eliminated.

In *Pullman*, the Court stated that:

> But no matter how seasoned the judgment of the district court may be, it cannot escape being a forecast rather than a determination. The last word on the meaning of Article 6445 of the Texas Civil Statutes, and therefore the last word on the statutory authority of the Railroad Commission in this case, belongs neither to us nor to the district court but to the supreme court of Texas.

312 U.S. at 499-500. Substitution of references to the Franchise Practices Act and the State of New Jersey in lieu of the references to the State of Texas and Article 6445 in the above-quoted portion of *Pullman* succinctly demonstrates the reason for abstention in this case. As noted by Judge Becker and ISI, there are no New Jersey cases to offer significant guidance in this area. Questions concerning the application of the Franchise Practices Act to the circumstances of this case both with regard to definitional requirements and jurisdictional application will do much to resolve the issues and possibly moot the entire matter.

CCC suggests this court should dispose of the numerous threshold issues regarding the applicability of the Franchise Practices Act before abstaining and remitting them to state court for a ruling on the extraterritorial reach of the Act. Citing to *Burton v. United States*, 196 U.S. 283, 295 (1905), CCC states that before a court may reach a constitutional

question, it must attempt to dispose of the case on non-constitutional grounds. According to CCC, because there are numerous non-constitutional reasons why ICI should lose this case, the court must address these issues before reaching CCC's constitutional argument. However, as CCC so forcefully argued in its initial submission, ICI invokes the Franchise Practices Act in a manner which may be unconstitutional. That is, if the New Jersey Legislature intended the Franchise practices Act to apply extraterritorially, this application may be unconstitutional, thereby rendering detailed analysis of ICI's franchise activities irrelevant. Similarly, if the New Jersey courts find the Franchise Practices Act was not intended to apply extraterritorially, as the court concluded in *Carlos v. Philips Business Systems, Inc.*, 576 F.Supp. 769 (E.D.N.Y), *aff'd*, 742 F.2d 1432 (2d Cir. 1983), ICI has no cause of action against CCC under the Franchise Practices Act.

In *Consumers Oil Corp. v. Phillips Petroleum Co.*, 488 F.2d 816 (3d Cir. 1973), the Circuit on its own motion directed the district court to stay the proceedings and found an "appropriate exercise of the policy of federal abstention pending . . . expeditious resort to a state court for a determination whether the [Franchise Practices] Act, . . . , applies to this case." *Id.* at 820.

In *Consumer Oil Corp.*, the Circuit noted that:

> In our view, these circumstances call for consideration of whether, in a case where jurisdiction is based soley upon diversity of citizenship, a federal court should abstain from attempting to anticipate the answer New Jersey courts would give to doubtful questions of interpretation of the New Jersey statute. Our concern is heightened by awareness that an interpretation of the Franchise Practices Act as prohibiting Phillips from discontinuing its operations throughout the state would precipitate substantial constitutional questions.

* * *

> Since these constitutional questions are substantial and the New Jersey courts might interpret the statute in a way that would avoid them, we think it appropriate that federal courts abstain from deciding the merits of the present controversy at this time.

Id. at 819 (footnotes omitted). The Circuit also noted that because there was uncertainty with regard to another issue which might render constitutional issues moot, there the meaning of the term "renewal," that issue should be presented to the New Jersey courts as well. *Id.* at 819-820 n. 3.

In this case, the facts are on a parallel and in one respect even stronger. In the present case, the Franchise Practices Act is at issue and a constitutional challenge in addition to challenges based upon non-constitutional issues (e.g., existence of a franchise, "place of business," "community of interest," "license") are present as in *Consumer Oil.* However, this matter was removed from state court; *Consumer Oil* was filed in federal court. In addition, ISI seeks to remit these issues to the state court while acknowledging the possibility of delay in decision.

In *Frederick L. v. Thomas*, 578 F.2d 513 (3d Cir. 1978) the issue of abstention was presented. The court in *Thomas* noted that the " 'classic' case for application of the *Pullman* doctrine involves a constitutional attack on a state statute under circumstances where one possible construction of the statute would avoid or substantially alter the constitutional issue." 578 F.2d at 516. It went on to note that:

> [T]he trial court was faced with a situation in which abstention would serve the dual purpose of permitting the Courts of Pennsylvania to decide an unclear question of state law in an area of particular state concern and of avoiding a decision on several federal constitutional questions unless and until it became clear that they must be decided. These are among the interests which the abstention doctrine was designed to serve.

Id. at 517-18. Likewise, in this case, a classic scenario is presented for the application of the *Pullman* doctrine through the presentation of unclear questions of state law in an area which appears to be of particular state concern. This point is forcefully made by the very wording of the Franchise Practices Act:

> The Legislature finds and declares that distribution and sales through franchise arrangements in the State of New Jersey vitally affects the general economy of the State, the public interest and the public welfare. It is therefore necessary in the public interest to define the relationship and responsibilities of franchisors and franchisees in connection with franchise arrangements.

N.J.S.A. 56:10-2.

Although the majority in *Thomas* found the application for abstention was timely, the dissent by Judge Gibbons strongly indicated that indeed it was not timely. In addition, he stated that: "In no case that I know of has *Pullman* abstention produced any but doleful consequences to the litigant who resorted to a federal forum." 578 F.2d at 518 (Gibbons, J., dissenting). Judge Gibbons noted that in *Thomas* the plaintiff would be forced to encounter difficulties similar to those which he had listed. A significant difference here, however, is that "the party bringing the lawsuit, ISI, is requesting an application of the *Pullman* doctrine and thus can not [sic] be heard to complain about any delays[1] caused by an abstention."[2] Plaintiff's Supplemental Memorandum at 4.

---

[1] Because of ISI's application to remit, the application for a preliminary injunction presently pending before this court is deemed withdrawn; this was confirmed at oral argument. I specifically note the issue of the application for a preliminary injunction is *not* remitted to the state courts for consideration because consideration of such an application would necessarily involve the constitutional issue which remains in this court.

[2] In its Supplemental Memorandum of Law on Abstention, CCC states it will be injured by abstention in this case. Other than merely asserting the contention of injury resulting from absention, CCC offers no basis to conclude injury will result. CCC Supplemental Memorandum at 10.

The threshold issue in this case is necessarily whether ICI has properly invoked the Franchise Practices Act. Before a court may legitimately consider whether ICI is a franchise within the meaning of the act and was terminated for good cause, it must ascertain whether the act applies as suggested by ICI. If the Franchise Practices Act does not apply extraterritorially, the court's inquiry on this issue is at an end, because a court should not work through the mechanics of a statute not properly placed before it. Without a determination concerning the intended reach of the Franchise Practices Act, this court must proceed down a long road of statutory analysis and fact finding, a road which may ultimately prove to have been travelled in vain.

Only by abstaining at this time and affording the courts of New Jersey a fair opportunity to provide a definitive interpretation of the Franchise Practices Act will judicial resources be expended wisely. As the Supreme Court observed in *Pullman*: "The reign of law is hardly promoted if an unnecessary ruling of a federal court is thus supplanted by a controlling decision of a state court. The resources of equity are equal to an adjustment that will avoid the waste of a tentative decision as well as the friction of a premature constitutional adjudication." 312 U.S. at 500.

By abstaining from reaching the merits of ICI's claim at this time, the judicial duty of this court is not abrogated. While abstention in a diversity case may be resorted to only in exceptional circumstances, the classic case for abstention arises where the challenged state statute is susceptible of a construction by the state courts which would avoid or modify the federal constitutional question. *Lake Carriers Ass'n v. MacMullan*, 406 U.S. 498, 510 (1972). By handling this case in this matter, not only are the state courts given the opportunity to confront and resolve unsettled questions of state law which are likely to arise again in the future, but this court avoids decision on a constitutional question until clearly necessary. *Frederick L.*, 578 F.2d at 517.

Finally, it is noted CCC is not deprived of its rights to a federal forum. While abstention in a diversity case which has been removed to federal court by the defendant necessarily postpones the defendant's substantive debut in a federal forum, the defendant may reserve its right to adjudicate its federal claims in federal court after the state court makes a definitive ruling upon the unsettled issue of state law. *England v. Louisiana State Board of Medical Examiners*, 375 U.S. 411, 417 (1964).

> Abstention in a diversity case is no more an abdication of the constitutional-statutory duty to decide than is abstention in the field of determination of federal questions in which the Federal Courts have a "primacy." *England v. Louisiana State Board of Medical Examiners*, [375 U.S. 411] 1964, 84 S.Ct. 461.
>
> Abstention is neither abandonment of *duty*, on the one hand, nor a problem of raw *power*, on the other. It is judge-fashioned and being such, the cloth should be cut to the pattern.
>
> The doctrine is, of course, a means devised to ameliorate some of the problems inevitably growing out of our unique federalism. For federal question cases, unseemly or unnecessary collision with a state is to be avoided, or at least postponed until such time as it is inescapable. Although the adjustment between the National Courts and a State takes a different turn in diversity cases, the underlying problem is essentially the same. And the impact—on local litigants and jurisprudence—is equally, if not more, awesome.

United Services Life Ins. Co. v. Delaney, 328 F.2d 483, 485-86 (5th Cir. 1964) (Brown, J. concurring) (footnotes omitted); *see also Fonaris v. Ridge Tool Co.*, 400 U.S. 41 (1970) (abstention in diversity case where defendant removed to federal court for Puerto Rican state court ruling on a vague contract statute).

As noted, CCC will not be forced to litigate its federal claims or defenses in state court. CCC can preserve its right to return to this forum for a determination of the constitutional issue by merely stating its reservation on the record before the state court. Pending resolution of the remitted issues, this matter will be stayed.

For the reasons stated, the above described issues will be remitted to the Superior Court of the State of New Jersey, Chancery Division, Passaic County, to afford that court (and appellate courts) the fair opportunity to resolve these issues. Pending the outcome of this procedure, this matter will be stayed and administratively terminated until these issues have been addressed by the New Jersey courts. Following a final decision by the New Jersey courts, if further action of this court is necessary, the parties will so inform the court at which time the matter will be reopened for determination, as appropriate.

SO ORDERED, this 20th day of July, 1989.

/s/ ALFRED J. LECHNER, JR.
Alfred J. Lechner, Jr., U.S.D.J.

AJL:kr
cc: Ellen Smith, Deputy Clerk

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

CIVIL ACTION NO. 89-502

Filed July 27, 1989

INSTRUCTIONAL SYSTEMS, INC.,

Plaintiff,

—v.—

COMPUTER CURRICULUM CORPORATION,

Defendant.

ORDER

IT IS, on this 27th day of July, 1989, pursuant to thisd Court's Letter-Opinion and Order, dated July 20, 1989,

ORDERED:

1. Plaintiff's application for a preliminary injunction is withdrawn;

2. The following issues arising under the New Jersey Franchise Practices Act, N.J.S.A. § 56:10-1 *et seq.* (the "Act"), as embraced in the First Count of the Complaint herein, are hereby remitted to the Superior Court of New Jersey, Passaic County (and such other courts of the State of New Jersey as the parties deem appropriate) for determination:

(a) Whether the Act has extraterritorial reach beyond the State of New Jersey and, if so, to what extent; and

(b) What are the definitions and standards of "community of interest," "license" and "place of business" under the Act?

3. Except as so expressly stated herein, this Court retains and reserves unto itself without limitation:

(a) Jurisdiction over this matter and the parties hereto;

(b) Application of the principles of law determined by the state court to the facts of this case;

(c) Any constitutional challenge to the Act; and

(d) Any application for injunctive or other interim relief.

4. Plaintiffs' request for reconsideration of the Court's Letter-Opinion and Order of July 20, 1989 is denied.

5. Pending a declaration by the Superior Court of the State of New Jersey, and any appellate review of such declaration as may be sought by the parties, this action, including all motions or cross-motions for summary judgment, is hereby administratively stayed and terminated. Following a final decision by the New Jersey courts, if additional action is necessary, the parties will so inform this court at which time this matter will be reopened for determination, as appropriate.

/s/ ALFRED J. LECHNER, JR.
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Supreme Court, U.S.
FILED
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(4)

No. 94-1033

In the

Supreme Court of the United States

October Term, 1993

COMPUTER CURRICULUM CORPORATION,
Petitioner,

v.

INSTRUCTIONAL SYSTEMS, INC.
and
DEBORAH T. PORITZ, ATTORNEY GENERAL
OF THE STATE OF NEW JERSEY
Respondents.

On Petition for Writ of Certiorari To The United States Court of Appeals for the Third Circuit

Brief in Opposition

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COUNTERSTATEMENT OF THE CASE

This litigation is between the plaintiff Instructional Systems, Inc. ("ISI") and the defendant Computer Curriculum Corporation ("CCC"), ISI being the New Jersey franchisee of CCC and marketing in New Jersey and at one point in almost a dozen other states a computerized teaching system; the Attorney General of New Jersey intervened as of right under 28 U.S.C.A. § 2403(b) when CCC contended that in its extraterritorial application the New Jersey Franchise Practices Act, N.J.S.A. 56:10-1 et seq., was unconstitutional under the Commerce Clause. On June 2, 1993, the United States District Court for the District of New Jersey held the Act unconstitutional on that account, Instructional Systems, Inc. v. Computer Curriculum Corporation, 826 F. Supp. 831 (D.N.J. 1993), but on September 16, 1994 the United States Court of Appeals for the Third Circuit reversed. Instructional Systems, Inc. v. Computer Curriculum Corporation, 35 F. 3d 813 (3d Cir. 1994). CCC having now petitioned this Court for certiorari, the Attorney General of New Jersey is filing this brief opposing that petition.

The plaintiff ISI is a New Jersey corporation having its primary place of business in New Jersey, while the defendant CCC is a Delaware corporation which is headquartered in Palo Alto, California and which produces and markets a computerized teaching system. Between 1974 and 1989, ISI was the exclusive distributor of CCC products in the Northeast, with the 1984-1989 period governed by a "Reseller Agreement" under whose terms ISI was the exclusive "reseller" of CCC products to certain categories of customers in New Jersey as well as in Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New York, Rhode Island, Vermont and Washington, D.C. The breadth of that territory was significantly narrowed in 1989, however. Assertedly dissatisfied with the ISI sales performance in much of the territory, CCC offered ISI a two-year contract which would encompass only New Jersey, New York and Massachusetts,

the three states in which ISI's marketing had been most successful; CCC would itself market its products in the remainder of the former ISI territory. Although ISI executed the new contract, it also sued CCC in the Chancery Division of the New Jersey Superior Court, alleging, among other matters, that ISI had been coerced into signing the new contract and that CCC had violated the New Jersey Franchise Practices Act.

CCC removed the suit to federal court on the basis of diversity of citizenship, but, on ISI's motion, the case was remanded to the New Jersey courts for consideration of State law issues, in particular, the extraterritorial effect of the Act. Railroad Commission of Texas v. Pullman Company, 312 U.S. 496, 61 S.Ct. 643, 85 L.Ed. 971 (1941); England v. Louisiana State Board of Medical Examiners, 375 U.S. 411, 84 S.Ct. 461, 11 L.Ed. 2d 410 (1964). After decisions by both the Chancery Division and the Appellate Division of Superior Court, the New Jersey Supreme Court held not only that the business relation between CCC and ISI is a "franchise" as defined by the Franchise Practices Act, Instructional Systems, Inc. v. Computer Curriculum Corporation, 130 N.J. 324, 347-66 (1992), but that the statute does have extraterritorial reach. Id. at 366-72.

In so deciding the latter issue, the New Jersey Supreme Court first addressed the question of choice of law. The 1984 Reseller Agreement specified that the legal relations betwen ISI and CCC would be governed by California law, and ordinarily the New Jersey courts will uphold the contractual choice if it does not violate New Jersey public policy. Id. at 341. Here, however, New Jersey did have a materially greater interest than California regarding ISI's rights under the agreement. Id. at 342-46. The New Jersey Supreme Court rejected CCC's argument that would split the contract into sales that occur in New Jersey and sales that occur in other States. Id. at 344. As the court said, "The

purpose behind franchise-act legislation is that dealers geographically 'situated' in a forum state are to be the desired beneficiaries of the legislation in order to make their bargaining position more equal to manufacturers," id. at 344-45 (citation and internal quotation marks omitted), and "[t]o strip away the spokes of a 'hub-type' franchise would counter the purpose of such legislation." Id. at 345.

> [A]ssume that an automobile manufacturer gave a franchise to a dealer in Montvale, New Jersey to serve northern Bergen County, New Jersey as well as Rockland County, New York. Would we assume that the New Jersey Legislature would be indifferent to the dealer's plight if, after [the dealer's] having made a substantial investment in the fixed plant and having created a market for the manufacturer's vehicle in Rockland County, the manufacturer, without good cause, took over the Rockland County market for itself? [Id. at 345]

ISI's situation, though not identical, was analogous. Few franchises are intrastate, and if parties were free to dispense with the protection afforded by franchise acts, any large franchisor, by insertion of a choice of law provision requiring the application of the franchisor's home State's law, could with a stroke of a pen remove the beneficial effect of the remedial legislation provided by the franchisee's State. Ibid.

> As the New Jersey Act and the cases interpreting it make clear, New Jersey has a strong policy in favor of protecting its franchisees. In this case, New Jersey has significant "contacts" with the transaction. The franchise is located here and the majority of ISI's employees reside in New Jersey. The franchise-specific investments ... relate primarily to the assets in New Jersey and the goodwill developed for CCC by New Jersey

> residents. New Jersey would undoubtedly be the state of applicable law had no choice-of-law provision existed. [Id. at 345-46]

Because ISI maintained a place of business in New Jersey and met all other requirements of the statute, New Jersey had the overriding interest in the fair treatment of its franchisee. Id. at 346.

The New Jersey Supreme Court then turned to the extraterritoriality aspect proper, considering it from the perspectives of both the Commerce Clause and the Due Process Clause. The court acknowledged that "[o]bviously, New Jersey has no power, and therefore no interest, to regulate commerce that occurs entirely beyond its borders." Id. at 367. Nevertheless, "[a] State's power over its own citizens should extend to protection of its own citizens' rights when dealing with others even though there may be incidental effects in other jurisdictions." Id. at 370.

> Were it otherwise, nearly every aspect of substantive state law would be disabled from affecting the conduct of multi-state corporations. When New Jersey law imposes a legal duty on the volitional behavior of a contracting party, that ruling will often have effects beyond state boundaries. For example, if the issue in this case were that of straight contract law, i.e., had the contract precluded termination of the out-of-state territory, the New Jersey common law upholding the contract would be regulating commerce that takes place wholly outside of the state's borders. [Id. at 369]

"In terms of state power, whether state contract law or state statutory law is applied to the in-state activity makes no difference." Ibid.

For these purposes, the New Jersey Supreme Court observed, the due process standard for choice of law, requiring contacts with the forum, interests arising from those contacts and fairness to the defendant, echoed the Commerce Clause balancing test of Pike v. Bruce Church, Inc., 397 U.S. 137, 90 S.Ct. 844, 25 L.Ed. 2d 174 (1970), in terms of legitimacy of the local interest and the reasonableness of the regulation. 130 N.J. at 369. In this situation:

> [f]airness to the defendant is implicit in the statute's requirements. By definition, the Act, and particularly its community-of- interest requirement, is intended to protect business parties who made a franchise-specific capital investment of either goods or services in New Jersey. [Citation omitted] Thus the statute's own terms, including the community-of-interest and good-cause requirements, will allow the application of the Act only in situations in which there are "contacts" with the forum, "interests" arising out of those contacts, and "fairness to the defendant" in the sense that a defendant who acts fairly with a franchisee need fear no oppressive regulation. Therefore, the Act's own terms curtail any impermissible extraterritorial effect and ensure its constitutionality under Commerce Clause or due-process analysis despite some incidental extraterritorial effects.[1] [Id. at

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[1] The New Jersey Supreme Court's remarks concerning the "community-of-interest" and "good cause" requirements were references to certain portions of the Franchise Practices Act. The statute defines "franchise" as

> a written arrangement for a definite or indefinite period, in which a person grants to another person a license to use a trade name, trade mark, service mark, or related characteristics, and in which there is a community of interest in the marketing of

A "critical factor in this case" was

> the installed base of customers that ISI has built up over a twenty-year period. Because of the peculiar

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> goods or services at wholesale, retail, by lease, agreement, or otherwise. [N.J.S.A. 56:10-3a.; emphasis added]

N.J.S.A. 56:10-5 declares that "[i]t shall be a violation of this act for a franchisor to terminate, cancel or fail to renew a franchise without good cause."

The terms "good cause" and "community of interest" have been given statutory and judicial definitions. Under the statute

> good cause for terminating, cancelling, or failing to renew a franchise shall be limited to failure by the franchisee to substantially comply with those requirements imposed upon him by the franchise. [N.J.S.A. 56:10-5]

The "community of interest" standard

> is based on the complex of mutual and continuing advantages which induced the franchisor to reach his ultimate consumer through entities other than his own which, although legally separate, are nevertheless economically dependent upon him. [Instructional Systems, Inc. v. Computer Curri-culum Corporation, 130 N.J. at 358, quoting Neptune T.V. & Appliance Service, Inc. v. Litton Microwave Cooking Products Division, 190 N.J. Super. 153, 163 (App. Div. 1983)]

In the present case, the New Jersey Supreme Court concluded that there was a community of interest between CCC and ISI. 130 N.J. at 362-66. Indeed, "[b]ecause of the extraordinary and intricate relations that arise in the distribution of computer products, a 'close symbiotic relationship' arises almost of necessity between manufacturers and distributors or resellers." Id. at 366.

> relationship between the [computer] hardware and the software, to terminate the franchise arrangements could be devastating within that customer base and could allow the franchisor unconscionably to reap the harvest of the franchisee's long years of effort. [Id. at 371]

The New Jersey Supreme Court noted, however, that "a termination might not be equally devastating in all jurisdictions." Ibid. The finder of fact would therefore have to consider all pertinent circumstances to determine whether invocation of the statutory protection against unconscionable conduct is warranted. Ibid.

The New Jersey Supreme Court having issued this decision, the case returned to the United States District Court, whereupon the defendant CCC moved for partial summary judgment upon the contention that the Franchise Practices Act offended the Commerce Clause of the United States Constitution. The District Court on June 2, 1993 granted partial summary judgment in favor of CCC. Instructional Systems, Inc. v. Computer Curriculum Corporation, supra, 826 F. Supp. at 834. The New Jersey Franchise Practices Act was found to violate the Commerce Clause to the extent that it might be applied to commercial transactions outside of New Jersey, id. at 849-51, and almost all of Count I was dismissed with prejudice.[2] Id. at 855.

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[2] The initial dismissal with prejudice of the entirety of Count I was later modified slightly to maintain the Count I allegations with respect to two states, New York and Massachusetts, because those states remained part of the ISI territory by virtue of a new reseller agreement signed in 1989.

The Court of Appeals reversed with respect to the Commerce Clause question.[3] The court first stressed that, CCC's argument to the contrary notwithstanding, the decision of the New Jersey Supreme Court during the State remand phase of the proceedings was binding as to the choice-of-law issue. Instructional Systems, Inc. v. Computer Curriculum Corporation, supra, 35 F. 3d at 823. In Pullman and England:

> [t]he Supreme Court did not expect the state courts to issue abstract opinions of law, removed from the facts of the case, or resolve factual disputes only to have them treated as advisory opinions. Instead, the Court anticipated that the state court decision might resolve the suit entirely. [Id. at 822]

The parties were thus bound by the State court judgment "even in the rare Pullman abstention case such as this, where the state court must resolve factual disputes or engage in a totality-of-the-circumstances analysis in reaching its conclusions." Id. at 823. With respect, then, to whether the parties' agreement was covered by the Franchise Practices Act, "we are bound to accept [the New Jersey court's] answer (yes), as well as the factual and legal findings necessary to that answer." Ibid.

With respect to the Commerce Clause question proper, the Third Circuit said:

> [It] is inevitable that a state's law, whether statutory or common law, will have extraterritorial effects. The Supreme Court has never suggested that the dormant Commerce Clause requires Balkanization,

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[3] The court affirmed the District Court judgment with respect to its entry of summary judgment favoring CCC on Counts II through VII. Instructional Systems, Inc. v. Computer Curriculum Corporation, supra, 35 F. 3d at 827, n. 19. This aspect of the Third Circuit opinion does not figure in the pending petition for certiorari.

> with each state's law stopping at the border. [Id. at 825]

In traditional contract litigation, courts must apply some State's law to interpret the contract, and

> [w]hile a contract which covers multiple states may raise a difficult choice-of-law question, once that question is resolved there is nothing untoward about applying one state's law to the entire contract, even if it requires applying that state's law to activities outside the state. [Ibid.]

Again contrary to CCC's argument, there was no distinction to be drawn between such an ordinary interpretive rule of State contract law and a state statute.

> The construction of a contract, including the interpretive policies embodied in common law and statutory enactments, is no more or less regulatory than the [New Jersey Franchise Practices Act], which imposes on franchises governed by New Jersey law certain provisions designed to promote fairness between the parties. [Ibid.]

Such was not to say, the Court of Appeals emphasized, that New Jersey would have a right to apply the Act to any franchise agreement in the country as long as suit were brought in New Jersey. Ibid. Nothing in the statutory text reached that far, however, for the statutory language itself limited the Act's compass to franchises the performance of which contemplates or requires the franchisee to establish or maintain a place of business within the State of New Jersey, N.J.S.A. 56:10-4, and the New Jersey Supreme Court had held that the Act by its own terms allows the application of statutory requirements only to situations in which there are contacts with the forum and interests arising out of those contacts. Instructional Systems, Inc. v. Computer

Curriculum Corporation, supra, 130 N.J. at 370-71. 35 F. 3d at 825.

> In this case the record is clear that it was the parties, not New Jersey, who contemplated that the franchisee maintain a place of business in New Jersey. And it was the parties, not New Jersey, who bound themselves to an exclusive multistate distribution agreement. Therefore, it is the parties' own agreement which operated to project the New Jersey law outside of New Jersey's borders, a result which CCC will find ironic but which inevitably follows from the choice-of-law analysis. [Ibid.]

It was this circumstance which distinguished this case from the liquor affirmation cases decided by this Court. In Healy v. Beer Institute, Inc., 491 U.S. 324, 109 S.Ct. 2491, 105 L.Ed. 2d 275 (1989), and Brown-Forman Distillers Corporation v. New York State Liquor Authority, 476 U.S. 573, 106 S.Ct. 2080, 90 L.Ed. 2d 552 (1986), the price-affirmation statutes involved were designed such that a liquor supplier's price in other States would be dependent on the prices which it posted in the State enacting the regulation. Id. at 825-26. Thus, "in these cases it was the state, operating independently of any parties' contract, which dictated the extraterritorial effect." Id. at 826. Such was not the situation here. The Third Circuit acknowledged that if the parties were subject to inconsistent legislation from different States, the practical effect of a particular law might lead to a Commerce Clause violation, but there must be shown actual conflict among State regulations for this result to occur. Ibid. State laws which merely create additional, but not irreconcilable, obligations are not to be deemed "inconsistent" for this purpose. Ibid. In general, consequently:

> [t]he essence of CCC's objection, despite its assurance to the contrary, goes to New Jersey's decision on choice of law. Having accepting that decision, as we must, we see no facial conflict between the [New Jersey Franchise Practices Act] and the dormant Commerce Clause. [Ibid.]

Having found the New Jersey statute not to be per se invalid, id. at 824-26, the Court of Appeals then considered the constitutionality of the statute under the balancing standard enunciated by this Court in Pike v. Bruce Church, Inc., 397 U.S. 137, 90 S.Ct. 844, 25 L.Ed. 2d 174 (1970). Applying this settled law, the Court of Appeals found it clear that the New Jersey Franchise Practices Act imposed no burden on interstate commerce inasmuch as the Act was facially neutral with respect to the interstate nature of the parties' agreement. Id. at 827. CCC contended that the statute imposed a straightjacket on its operations and ultimately harmed consumers by prohibiting the creation of an efficient distribution system.

> But even assuming this to be true, it is indisputable that the statute simply does not differentiate between in-state and out-of-state franchisors. The limitation on termination of franchises to reasons of good cause is equally applicable to New Jersey-based franchisors as to those headquartered elsewhere. Thus, although the [Franchise Practices Act] may burden commerce, it creates no incidental burdens on interstate commerce for purposes of Pike balancing. [Ibid.]

Because of the absence of such a burden, there was no need to consider the putative local benefits produced by the Act. Ibid.[4]

CCC has now petitioned this Court for certiorari. This brief opposes that petition.

[4] Having adjudicated the facial constitutionality of the statute, the Third Circuit withheld comment regarding whether the Act, when applied, might have a burdensome effect on interstate commerce. That issue could not be resolved as a matter of law and might have to await the interpretation given to the statutory provision concerning "good cause" for franchise termination. Ibid.

SUMMARY OF ARGUMENT

With the petitioner having abandoned its contention, previously pressed in both the District Court and the Court of Appeals, that the New Jersey Franchise Practices Act in its extraterritorial application was somehow "per se invalid" and apparently having now come to agree that the statute is facially neutral and nondiscriminatory, all parties now agree that the Pike v. Bruce Church dormant Commerce Clause balancing standard alone is applicable to this case. The Act plainly is constitutional under the Pike standard, for not only does it regulate even-handedly and thereby effectuate the legitimate local public interest of protecting franchisees from imposition by more powerful franchisors, but its extraterritorial effects -- its burden upon interstate commerce -- are minimal and incidental and certainly no greater than the effects which any State regulatory system inevitably will produce.

Moreover, the adverse ramifications of the holding which this petitioner wants from this Court are truly enormous and unsettling. In all subject areas, the petitioner would have not only the State legislatures, but also the State judiciaries, rendered powerless to protect classes of persons from unconscionable overreaching to the extent that the transactions in question have any effect in the interstate market. The petitioner wants in the interstate arena a supposedly constitutionally-mandated return to laissez faire, a result which most assuredly is not required by the dormant Commerce Clause or by any other constitutional provision. The petition for certiorari therefore should be denied.

ARGUMENT

NOT ONLY DOES THE NEW JERSEY FRANCHISE PRACTICES ACT CLEARLY REGULATE EVEN-HANDEDLY TO PROTECT FRANCHISEES FROM MORE POWERFUL FRANCHISORS WITH ONLY THE INCIDENTAL EFFECTS ON INTERSTATE COMMERCE PRODUCED BY ANY REGULATORY SCHEME, BUT THE HOLDING SOUGHT BY THIS PETITIONER WOULD PRODUCE LAISSEZ FAIRE IN THE INTERSTATE ARENA BY STRIPPING FROM THE STATES ALL REGULATORY POWER HAVING ANY EXTRA-TERRITORIAL EFFECT, AND THEREFORE THE PETITION FOR CERTIORARI SHOULD BE DENIED.

When reviewing the CCC petition for certiorari, this Court must, of course, consider the application from the perspective of the applicable legal standard, and the applicable legal standard is that enunciated in Pike v. Bruce Church, Inc., 397 U.S. 137, 90 S.Ct. 844, 25 L.Ed. 2d 174 (1970). Indeed, it must be stressed that the Pike v. Bruce Church standard is the only standard which this Court is being asked to consider. CCC, despite having persistently and vigorously argued in both the District Court[5] and in the Court of Appeals[6] that the New Jersey Franchise Practices Act in its extraterritorial application was somehow "per se invalid," has now abandoned that contention; as a corollary, CCC also apparently now agrees that the statute is facially neutral (Petition at 25) in that it does not discriminate

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[5] Instructional Systems, Inc. v. Computer Curriculum Corporation, 826 F. Supp. 831, 847 (D.N.J. 1993).

[6] Instructional Systems, Inc. v. Computer Curriculum Corporation, 35 F. 3d 813, 824 (3d Cir. 1994).

between in-state and out-of-state franchisors (Petition at 27). Thus, all parties now agree that the Pike v. Bruce Church balancing standard alone is applicable to this case.

> Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. [Citation omitted] If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities. [397 U.S. at 142]

This formulation has often been stated and applied, but, as the Court of Appeals concluded, it is to be applied here upon the dual recognition that (1) some extraterritorial incidents of a State's law are inevitable and (2) from the perspective of the jurisdictions where those extraterritorial incidents occur, they will always inevitably be governed by the law of a "foreign" State. Instructional Systems, Inc. v. Computer Curriculum Corporation, 35 F. 3d at 825. Neither of these circumstances implicates the dormant Commerce Clause.

It is this latter proposition especially which cannot be denied. CCC may decry that part of the analysis that deals with choice of law (Petition at 22), but, as the Court of Appeals said, even "in traditional contract litigation, courts must apply some state's law to interpret the contract." Ibid. Law is, after all, essential to commerce; it is the oil that keeps the machinery of interstate commerce running. Some law must apply. That is the purpose of choice of law precepts. In consequence, it is understood that in some

circumstances relationships will be governed by rules of law specified by a State other than the State in which one or more of the parties are situated. The proposition is entirely unexceptionable.[7]

Equally unexceptionable is the fact that New Jersey has chosen to regulate franchising arrangements. The petitioner may suggest that New Jersey is one of "only" eighteen States that have adopted any form of a franchise termination statute and "only" one of nine States that compel the renewal of a franchise after its stated expiration date (Petition at 13), but those figures signify that fully one-third of the States are concerned enough about franchising to impose some regulatory limits and that 18% of the States deal in some respect with the adverse effects of unjust franchise termination. While the regulating States may vary in terms of the specific details of their legislative public policies and their ensuing regulatory requirements, the public policy findings declared by the New Jersey Legislature surely are not unreasonable.

> The Legislature finds and declares that distribution and sales through franchise arrangements in the State of New Jersey vitally affects the general economy of the State, the public interest and the public welfare. It is therefore necessary in the public interest to define the relationship and responsibilities of franchisors and franchisees in

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[7] The proposition is, moreover, as applicable in the federal courts as in the State courts. It was in the Erie case, of course, Erie Railroad Company v. Tompkins, 304 U.S. 64, 78, 58 S.Ct. 817, 82 L.Ed. 1188 (1938), that this Court repudiated the notion that federal courts in diversity actions are to apply a body of law other than the particular State law that ordinarily would govern the transaction. Cf. Swift v. Tyson, 41 U.S. 1, 10 L.Ed. 865 (1842). The State law which governs in the federal forum furthermore includes State choice of law. Klaxon Company v. Stentor Electric Manufacturing Company, 313 U.S. 487, 496, 61 S.Ct. 1020, 85 L.Ed. 1477 (1941).

> connection with franchise arrangements. [N.J.S.A. 56:10-2]

The Franchise Practices Act was intended to rectify the lack of equal bargaining power between franchisor and franchisee. Westfield Centre Service, Inc. v. Cities Service Oil Company, 86 N.J. 453, 462 (1981).

One would think from reading the petition for certiorari that extraterritorial application of this entirely understandable New Jersey public and legislative policy would constitute a steel gate descending into other jurisdictions and absolutely foreclosing CCC from ever selling any of its products there. One would think also that by virtue of the Act CCC is bound into a "perpetual relationship" with ISI (Petition at 18) irrespective of how poorly the franchisee might have fulfilled its franchise obligations. Such is simply not the law under the Franchise Practices Act. For there even to be a "franchise" under the Act, a "community of interest," with that term having specified requirements, must exist between the contracting parties.[8] See n., p. 5, supra. Furthermore, under N.J.S.A. 56:10-5:

> [i]t shall be a violation of this act for a franchisor to terminate, cancel or fail to renew a franchise without good cause. For the purposes of this act, good cause for terminating, cancelling, or failing to renew a franchise shall be limited to failure by the franchisee to substantially comply with those requirements imposed upon him by the franchise.

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[8] That the statute applies only when there is this community of interest between the parties underscores the fact that New Jersey has exercised its regulatory power precisely in those circumstances in which there is a bona fide State interest in protecting the weak from the strong.

It is true that the Legislature has thereby excluded what would ordinarily be deemed "bona fide business reasons" for terminating a franchise from the circumstances authorized under the statute. Westfield Centre Service, Inc. v. Cities Service Oil Company, 86 N.J. at 469. It is not true, however, that the franchisor has no recourse whatever.

> The evident purpose of the statutory and common law termination requirements ... is the protection of franchisees who have conscientiously striven to carry out their obligations under the franchise agreement. They were not intended to prevent the severance of those who deliberately disregard reasonable requirements contained in their contract with the franchisor. [Amerada Hess Corporation v. Quinn, 143 N.J. Super. 237, 254 (Law Div. 1976)]

Indeed, as when a franchisee violates laws pertaining to its operations, "protection of the public's welfare points toward termination of dishonest franchisees." Ibid. CCC has in fact asserted franchise noncompliance against ISI in this very litigation.

The New Jersey Franchise Practices Act plainly passes muster under the dormant Commerce Clause. The statute does regulate even-handedly -- even the petitioner so acknowledges -- and, beyond question, it does effectuate the legitimate local public interest of protecting franchisees from imposition by more powerful franchisors. Furthermore, CCC's argument to the contrary notwithstanding, the effects of the Act on interstate commerce are only incidental. The Commerce Clause focus cannot be on the facts that non-residents of New Jersey may be involved and that the goods -- the computer hardware and software, presumably -- would originate outside New Jersey and would move in interstate commerce without ever passing through New Jersey (Petition at 11). As will shortly be discussed, these

circumstances are often present, and not only when a State legislature enacts statutes. They are also present when the courts of a particular State refuse to enforce or alter a contract which has extraterritorial effects but is contrary to State public policy. Yet Commerce Clause invalidation of even such State judicial rulings is where the petitioner's theory inexorably leads. To paraphrase the law review commentary quoted by the Court of Appeals here, the prohibition on dormant Commerce Clause grounds of such clearly appropriate judicial decisions "would invalidate much too much legislation."[9] Instructional Systems, Inc. v. Computer Curriculum Corporation, supra, 35 F. 3d at 825, quoting Donald H. Regan, Siamese Essays: (I) CTS Corp. v. Dynamics Corp. of America and Dormant Commerce Clause Doctrine; (II) Extraterritorial State Legislation, 85 Mich. L. Rev 1865, 1878 (1987).

The extraterritorial effects in the present case are, it must be emphasized, by no means comparable to those in Healy v. Beer Institute, Inc., 491 U.S. 324, 109 S.Ct. 2491, 105 L.Ed. 2d 275 (1989). Healy concerned a liquor affirmation statute which required out-of-state shippers to make a contemporaneous affirmation that their posted prices for products sold to Connecticut wholesalers were at the time of posting no higher than the prices for the same products sold in bordering States. This Court invalidated the regulatory scheme because of a fundamental concern which does not exist in the present case.

> [T]he practical effect of this affirmation law, in conjunction with the many other beer-pricing and

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[9] As will be discussed, State judicial decisions of this sort include such landmark precedents as Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358 (1960). Such decisions may appropriately be deemed "legislation," because, in addition to adjudicating the rights of the particular parties to the litigation, they also specify rules of conduct for the future. See 1 Kenneth Culp Davis, Administrative Law Treatise § 7.02, at 413 (1958).

> affirmation laws that have been or might be enacted throughout the country, is to create just the kind of competing and interlocking local economic regulation that the Commerce Clause was meant to preclude. [491 U.S. at 337]

With each shipper being bound by the prices posted for that month of sales in every other State, the result would be "price gridlock" -- a "short-circuiting of normal pricing decisions based on local conditions ...." Id. at 340.

"Price gridlock" was indeed the concern, but the concern was also that the regulating State was taking advantage of more favorable economic conditions in other States. By means of its statute, Connecticut was in effect reaching out to the more favorable competitive conditions extant in other States and then importing those conditions into its own jurisdiction; by dint of its own otherwise limited regulatory authority, Connecticut was distorting each of the local markets all over the country and transmuting all of those individual markets into a kind of national market whose most advantageous outcome was directed toward Connecticut as beneficiary. That is not the situation here. New Jersey through its Franchise Practices Act is not reaching out to any condition that may be extant in some other State; New Jersey is not attempting to distort local markets elsewhere for its own benefit. Instead, it is simply mandating that those outside interests that choose to come into New Jersey abide by New Jersey's justifiable and entirely reasonable regulatory requirements.[10]

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[10] The present case also is entirely unlike Edgar v. MITE Corporation, 457 U.S. 524, 102 S.Ct. 2629, 73 L.Ed. 2d 269 (1982), concerning the Illinois Business Take-over Act, which imposed restrictions upon tender offers for stock of a "target company." Because a company would meet the statutory definition of "target company" merely by being organized under Illinois law and having its principal executive office in that State, the statute on its face would apply "even if not a single one of the [target company's] shareholders were a resident of Illinois." 457 U.S. at 642. The MITE decision thus reflected a strong due process concern on the part

Others of the CCC arguments need be addressed only briefly. The present case obviously is not at all like the precedents of this Court concerning the "methods" or facilities by means of which goods are distributed in interstate commerce (Petition at 15). Cf., e.g., Bibb v. Navajo Freight Lines, Inc., 359 U.S. 520, 79 S.Ct. 962, 3 L.Ed. 1003 (1959); Southern Pacific Company v. Arizona ex rel. Sullivan, 325 U.S. 761, 65 S.Ct. 1515, 89 L.Ed. 1915 (1945). The New Jersey Franchise Practices Act does not act in any way even remotely comparable to regulations of train lengths and the like; the attempted analogy is nonsensical. Similarly, CCC may attempt to denigrate the finding of the Court of Appeals that it was the petitioner's own agreement with ISI that brought CCC under the umbrella of New Jersey law (Petition at 18-21), Instructional Systems, Inc. v. Computer Curriculum Corporation, 35 F. 3d at 825, but such is precisely what happened. The point is not, as CCC would have it (Petition at 19-20), that New Jersey has tried to coerce CCC into forfeiting some constitutional "right" to bring its business into the State. Rather, the point is, again, that in every commercial transaction the law of some State must apply and that CCC, a commercial entity not without adequate legal and other resources to research and deliberate contemplated business decisions, should have known that a decision to do business with a New Jersey franchisee would entail the New Jersey common and statutory law governing

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of this Court, as is clear from this quotation:

> [A]ny attempt "directly" to assert extraterritorial jurisdiction over persons or property would offend sister States and exceed the inherent limits of the State's power. [Id. at 643]

The quotation was taken from Shaffer v. Heitner, 433 U.S. 186, 197, 97 S.Ct. 2569, 53 L.Ed. 2d 683 (1977), which had extended the minimum contacts requirement of in personam jurisdiction to in rem and quasi in rem jurisdiction. Plainly that concern is not present here.

franchising arrangements. The petitioner simply has no cause to complain.

While the foregoing discussion has addressed and answered the petitioner's various arguments, it is important to point out that, disguised beneath those arguments, much more is going on here. The petitioner's purpose is assuredly not to vindicate the interests of a national economic union which underlie the dormant Commerce Clause. CCC's purpose is, rather, considerably more provincial -- as a franchisor and presumably on behalf of all other franchisors in the Nation that award franchises having any multi-state effects, to be rid of any governmental regulation in the interstate arena. Beneath the Commerce Clause rhetoric, this petitioner wants a return to the Lochner era of laissez faire. Lochner v. New York, 198 U.S. 45, 25 S.Ct. 539, 49 L.Ed. 937 (1905).

As far as CCC is concerned, the issue here is far broader than whether a State legislature may enact statutory law to protect franchisees from the disproportionate bargaining power enjoyed by typically vastly larger franchisors. For CCC, the question is whether even a State judiciary may draw upon the common law to protect a franchisee in the interstate market. For CCC, the words of the contract are sacrosanct, immune from alteration in the public interest by either legislature or court. If a contract has any effect whatever on interstate commerce, a State court may construe and enforce the contract, but only by using rules of contract interpretation which "honor the parties' agreement" (Petition at 19) and which "enforce contracts according to their terms" (Petition at 24, n. 25). There can be no State laws, whether legislative or court-made, that "are exercises of state power imposing restrictions on out-of-state distribution contrary to the terms of the contract" (Petition at 19). The intended result is obvious -- an interstate market which would be utterly free

of any control save the control exercised by the more powerful of contracting parties.

The implications of a holding by this Court that interstate commerce as a matter of constitutional law under the dormant Commerce Clause must be totally bereft of State regulation are thus enormous. The power of every State, reposed not only in its legislature, but also in its judiciary, to act protectively on behalf of its citizens would be stripped away insofar as there were any extraterritorial incidents of State regulation. The dormant Commerce Clause has never been understood that way, and, if it were, the new doctrine would radically change the judicial and legislative processes in all of the States. From the judicial standpoint, it has always been understood, in New Jersey and undoubtedly in most if not all of the other States, that "a contract is ... unenforceable where it is held to be contrary to public policy." Manning Engineering, Inc. v. Hudson County Park Commission, 74 N.J. 113, 138 (1977). This principle inevitably will often have some extraterritorial impact. If that impact is to be deemed unconstitutional, the very fabric of American law will be fundamentally changed, and not for the better.

For example, when the New Jersey Supreme Court in the seminal Henningsen decision announced that the New Jersey courts would not enforce automobile manufacturer and dealer warranties deemed contracts of adhesion, Henningsen v. Bloomfield Motors, Inc., n., p. ___, supra, 32 N.J. at 403-404, 406-408, it made that decision with respect to goods -- automobiles -- which were in the interstate stream of commerce. Doubtless, the restrictive New Jersey law had some effect on that interstate commercial stream, and not necessarily solely with respect to automobiles that would now be coming into New Jersey for sale. The New Jersey court-made law allowing greater manufacturer liability might well have induced manufacturers to build stronger, safer (and more expensive)

automobiles for sale in New Jersey, but as a practical matter those manufacturers would not have been likely to manufacture the same model of automobile under separate sets of quality standards, with one group of manufactured cars being destined for sale in New Jersey and the other group destined for sale in States having less demanding laws. Inevitably, therefore, New Jersey's more rigorous legal requirements would have an effect -- economists might even characterize it as a "distorting" effect -- on prices and perhaps on other circumstances involved in automobile sales in other States. Yet it never occurred to anyone that the New Jersey courts by virtue of the dormant Commerce Clause were bound to disregard the patent unfairness of the contract of adhesion and instead, in the words of the present petitioner, "honor the parties' agreement."

With regard in particular to franchising, the activity involved in the present case, New Jersey through both its courts and its Legislature has long expressed a public policy to counteract the bargaining unfairness which often is to be found in franchising arrangements. Significantly, CCC in this Court has abandoned its conceptually-doomed attempt to distinguish between State public policy regulation of contracts through judicial decision and State public policy regulation of contracts through legislation (Petition at 19), and for good reason. There is no such distinction. At the time of decision in Shell Oil Company v. Marinello, 63 N.J. 402 (1973), cert. den. 415 U.S. 920, 94 S.Ct. 1421, 39 L.Ed. 2d 475 (1974), the New Jersey Franchise Practices Act had been enacted, but because of the timing of its enactment was not applicable to the parties to the litigation. Id. at 409. Nevertheless, the New Jersey Supreme Court found in New Jersey common law public policy values identical to those articulated in the statute. It was apparent that

> Shell is the dominant party and that the relationship lacks equality in the respective bargaining positions

> of the parties. For all practical purposes Shell can dictate its own terms. The dealer, particularly if he has been operating the station for a period of years and built up its business clientele, when the time for renewal of the lease and dealer agreement comes around, cannot afford to risk confrontation with the oil company. He just signs on the dotted line. [Id. at 408]

The New Jersey Supreme Court therefore stated the common law and common sense principle.

> Where there is grossly disproportionate bargaining power, the principle of freedom to contract is non-existent and unilateral terms result. In such a situation courts will not hesitate to declare void as against public policy grossly unfair contractual provisions which clearly tend to the injury of the public in some way. [Ibid.]

Under New Jersey common law, consequently, the contract would be read to mean that the franchisor did not have the unilateral right to terminate the franchise in the absence of a showing of good cause, i.e., that the franchisee had failed to substantially perform his obligations. Id. at 410-11. The common law standard chosen was identical to that articulated in the statute. N.J.S.A. 56:10-5.

Yet in Marinello too, there was some conceivable impact on interstate commerce which could conceivably have implicated the dormant Commerce Clause. The service station was located in Fort Lee, New Jersey, id. at 404, near the George Washington Bridge, a major transportation link between New Jersey and New York City, and conceivably the oil company, had it not been ordered by the New Jersey courts to keep the service station open in the absence of good cause for terminating the franchise, might have determined to forego the New Jersey location

entirely in favor of relocating to New York. Nevertheless, the dormant Commerce Clause argument seems to have slipped by all counsel as well as the court. The reason is obvious, as the Court of Appeals in the present case said.

> [I]t is inevitable that a state's law, whether statutory or common law, will have extraterritorial effects. The Supreme Court has never suggested that the dormant Commerce Clause requires Balkanization, with each state's law stopping at the border. [Instructional Systems, Inc. v. Computer Curriculum Corporation, supra, 35 F. 3d at 825]"

Again, the result urged by this petitioner is most remarkable. The result would not be comparable even to that of the long-overruled Swift v. Tyson, n., p. 16, supra, under which the governing law in federal court diversity cases was to be federal court-made law rather than the applicable State law. CCC does not want the interstate market in franchises to be governed by federal court-made law; CCC wants that market to be governed by no law whatever, save judicial "enforce[ment] [of] contracts according to their terms" (Petition at 24, n. 25). If pressed, the petitioner under its theory of this case probably would concede that it could be subjected to governmental regulation imposed either by Congressional legislation applicable to the entire Nation or imposed by some uniform statute adopted verbatim by each of the fifty States.[11] Both

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[11] The most obvious example of a uniform statute is, of course, the Uniform Commercial Code. In actuality, the UCC in most respects has been adopted in substantially identical form in all fifty States, but one must wonder how the petitioner would argue if New Jersey, of all the States, were the only one to have adopted the provision of Article 2 concerning unconscionable contracts.

> If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the

of these alternatives are nonetheless entirely unlikely, and in their absence, CCC would be pleased to enjoy the laissez faire benefits of a regulatory desert.

Such a regulatory desert does not exist, however, and it certainly is not required by the dormant Commerce Clause. The local benefits to be weighed under the Pike v. Bruce Church balancing standard are unquestionably substantial, and the burden upon interstate commerce is minimal -- certainly no greater than the effect which any State regulatory system inevitably will produce. As noted previously, moreover, the ramifications of what CCC wants from this Court are truly enormous and unsettling. The petitioner may or may not be correct in its description of how various of the States prefer to deal with franchising in particular (Petition at 13). The petitioner nonetheless is most certainly incorrect in its implication that each of the other forty-nine States would be pleased to have its regulatory power, judicial as well as legislative, amputated at its border notwithstanding the realistic and common sense understanding that a very substantial proportion of commercial transactions having a nexus to the regulating State will inevitably have some extraterritorial incidents.[12]

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unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result. [N.J.S.A. 12A:2-302(1)]

One may consider in this hypothetical situation a contract between parties which had a sufficient due process nexus to New Jersey to justify the application of this New Jersey statutory law by a New Jersey court, but which nonetheless implicated another jurisdiction because that was where one of the contracting parties resided. Under the CCC theory, despite the fact that the New Jersey court would be wholly justified under accepted choice-of-law principles in applying New Jersey law, it would be precluded from doing so by the supposed demands of the dormant Commerce Clause. The proposition on its face makes no sense whatever.

[12] The New Jersey Supreme Court in this case made the point cogently by hypothesizing an automobile dealership franchise located in northernmost New Jersey but covering southern New York. The court

The States may vary in their regulatory treatment of franchising specifically, but they do not vary in their broader desire to afford protection in innumerable subject areas to innumerable classes of persons within their jurisdiction. The States are not to be shorn of that authority.

Clearly, then, this petitioner simply wants laissez faire in the interstate market -- a regime in which the more powerful could control the less powerful through supposedly "consensual" agreements (Petition at 19) which are to be enforced solely "according to their terms" (Petition at 24, n. 25). The novel constitutional doctrine which CCC would have this Court announce would in this case be applied to franchising, but by its nature it would apply to all manner of other commercial transactions. It would fundamentally change the American legal system. Nothing in the dormant Commerce Clause or anywhere else in the Constitution supports this sort of radical alteration, and therefore the petition for certiorari should be denied.

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could not conceive that the New Jersey Legislature would be indifferent to the dealer's plight if, after his or her having made a substantial investment in the franchise and having created a market for the franchisor's vehicle in southern New York, the franchisor without good cause took over the sourthern New York market for itself. Instructional Systems, Inc. v. Computer Curriculum Corporation, supra, 130 N.J. at 345. This hypothetical situation and the entirely understandable legislative and judicial response to it only underscore how nonsensical is the notion that, in the words of the Court of Appeals, "the dormant Commerce Clause requires Balkanization, with each state's law stopping at the border." Instructional Systems, Inc. v. Computer Curriculum Corporation, 35 F. 3d at 825.

CONCLUSION

For these reasons, it is respectfully submitted that the petition for certiorari should be denied.

Respectfully submitted,

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Dated: January 17, 1995

No. 94-1033

IN THE
Supreme Court of the United States
OCTOBER TERM, 1994

COMPUTER CURRICULUM CORPORATION,
Petitioner,
v.
INSTRUCTIONAL SYSTEMS, INC.
and
DEBORAH T. PORITZ, ATTORNEY GENERAL
OF THE STATE OF NEW JERSEY,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

MOTION FOR LEAVE TO FILE BRIEF *AMICI CURIAE* AND BRIEF *AMICI CURIAE* OF THE NATIONAL ASSOCIATION OF MANUFACTURERS AND THE SOFTWARE PUBLISHERS ASSOCIATION IN SUPPORT OF PETITIONER

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MOTION FOR LEAVE TO FILE BRIEF *AMICI CURIAE*

The National Association of Manufacturers of the United States of America ("NAM"), and the Software Publishers Association ("SPA"), hereby move, pursuant to Rule 37.2 of the rules of this Court, for leave to file the attached brief *amici curiae* in support of petitioner. Counsel for petitioner has consented to the filing of this brief, but counsel for respondent Instructional Systems, Inc. and respondent Deborah T. Poritz, Attorney General of the State of New Jersey, have declined.

The NAM is a voluntary business association of more than 13,000 companies and subsidiaries, employing 85 percent of all manufacturing workers and producing more

than 80 percent of the nation's manufactured goods. More than 158,000 additional businesses are affiliated with the NAM through its Associations Council and National Industrial Council.

The SPA is the principal trade association of the personal computer software industry. With over 1,100 members ranging from well-known public companies to numerous smaller private companies, the SPA represents 90 percent of U.S. software publishers. Members of the SPA account for more than seventy-five percent of total worldwide personal computer software sales and represent some of the United States' most technologically advanced, competitive and innovative companies.

The NAM and the SPA are vitally interested in ensuring that state regulation that affects interstate commerce is fair, reasonable, and properly restrained by clear constitutional principles. The NAM and the SPA also believe that the consuming public is best served when parties are free to enter into voluntary and mutually satisfactory contractual arrangements, and that those market-based agreements will best promote the efficient and economical distribution of goods and commodities from producers to consumers.

This case involves issues of industry-wide importance. First, the specific law in question affects manufacturers throughout the country because New Jersey is a major distribution center. Second, the rationale relied on by the decision below would sanction extraterritorial regulation by states of any producer who enters into any contract within the state. Because of the NAM's broad representation of manufacturing companies, and the SPA's broad representation of software publishers, they are familiar with the import of the decision below with respect to interstate commerce and believe that their views will be of assistance to this Court.

For these reasons, the NAM and the SPA ask that their motion be granted.

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On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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BRIEF *AMICI CURIAE* OF THE NATIONAL ASSOCIATION OF MANUFACTURERS AND THE SOFTWARE PUBLISHERS ASSOCIATION IN SUPPORT OF PETITIONER

INTEREST OF *AMICI CURIAE*

The interest of *amici curiae* is set forth in the accompanying motion.

STATEMENT

The decision below upheld a New Jersey statute that has been interpreted by the highest state authority to prohibit out-of-state suppliers from terminating multistate distribution contracts with New Jersey-based distributors,

unless they establish certain preconditions. Under the statute, such contracts must be renewed unless the supplier proves that the distributor substantially breached the agreement—even if the distributor expressly agreed that the contract would expire on a date certain and that the law of a different state was intended to govern the contract.

The Third Circuit rejected petitioner's argument that, under the Commerce Clause, New Jersey has no power to require an out-of-state supplier to renew an expired contract that covers distribution and sales beyond New Jersey's borders. Instead, the court ruled that New Jersey's regulation should be viewed as an interpretive rule of contract, and as such can be enforced with respect to commerce anywhere in the United States, so long as other states have not enacted positive law that imposes inconsistent obligations.

ARGUMENT

The Third Circuit's decision permits a single state to prevent any changes in the systems used for distribution of products and services in other states. That decision warrants review for two reasons. First, it endorsed as constitutional a form of state regulation that is inherently protectionist and thus upsets the equilibrium between states that is essential to the national economy. Because supervision of the extent to which one state may constitutionally impose its policy choices on other states is a core function of this Court, and because the decision below sanctioned overreaching by one state at the expense of others, the question presented here is clearly worthy of this Court's consideration.

Moreover, there would be serious practical consequences if the Court were to defer its consideration of the issue until some later opportunity arises. The Third Circuit's decision has upset settled expectations of the many companies that distribute their products through

New Jersey distributors. In such a significant commercial context, uncertainty about the basic rights of contracting parties is intolerable. And so long as the decision below remains in place, producers will be forced to refrain from changing to new and more efficient means of distribution. For these reasons, the Court should grant the petition for a writ of certiorari.

I. THE THIRD CIRCUIT'S DECISION TO PERMIT STATES TO REGULATE COMMERCE OUTSIDE THEIR BORDERS IS INCONSISTENT WITH THIS COURT'S COMMERCE CLAUSE JURISPRUDENCE.

By freezing distribution contracts between suppliers, wherever located, and New Jersey-based distributors, the New Jersey statute upheld by the Third Circuit permits New Jersey to prevent suppliers from terminating New Jersey-based distributors, without regard to the actual contractual terms agreed to by the New Jersey distributor, and without regard to the interests of the other states where the supplier's products will be sold and/or delivered. Thus, for example, an out-of-state manufacturer is not free to replace a New Jersey-based distributor with a Massachusetts-based distributor even to sell and/or distribute products in Massachusetts, and even though the New Jersey distributor's contract has expired. Essentially, once a supplier enters into a contract with a New Jersey-based distributor, it is caught in New Jersey's web. The availability, price, delivery and selection of products in *entirely different states* is held hostage unless and until the manufacturer undertakes the expense of highly fact-intensive litigation and successfully meets the restrictive test imposed by New Jersey law.[1]

The New Jersey law upheld below is precisely the type of protectionist regulation this Court has long held unconstitutional under the dormant Commerce Clause. Even

[1] Under that test, even *bona fide* business reasons are insufficient to justify termination of the New Jersey-based distributor. *See* Pet. at 2.

where a state is regulating suppliers *within* its borders, this "Court has viewed with particular suspicion state statutes requiring business operations to be performed in the home State that could more efficiently be performed elsewhere" and has declared them "virtually per se illegal." *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 145 (1970). The statute at issue in this case lacks even that connection with the state. The New Jersey law effectively requires *out-of-state producers* selling and delivering products to *out-of-state buyers* to continue to use New Jersey firms as their distributors—even if an out-of-state distributor (or the manufacturer itself) could distribute the products more efficiently.

That New Jersey may have legitimate local interests is irrelevant, because the Commerce Clause does not permit New Jersey to hobble businesses from other states in their competition with New Jersey firms. *See Brown-Forman Distillers Corp. v. N.Y. Liquor Auth.*, 476 U.S. 573, 580 (1986) (although a state may seek benefits for its citizens, "it may not insist that producers or consumers in other States surrender whatever competitive advantages they may possess"); *Healy v. The Beer Institute*, 491 U.S. 324, 346 (1989) (Rehnquist, C.J., dissenting) (noting that, in *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 521 (1935), the Court struck down a New York price minimum aimed at equalizing the wholesale cost of milk because it forced out-of-state firms "to give up the natural advantage which they would otherwise have obtained" from their lower production costs).

But, in fact, hobbling out-of-state businesses is precisely what the New Jersey law does. When a Maine-based distributor and a New Jersey-based distributor compete for the right to distribute a supplier's products *in Maine*—after the supplier's contract with the New Jersey distributor has expired—the New Jersey statute grants the New Jersey company a decisive advantage. It imposes a heavy cost on the supplier if it chooses the Maine-based distributor (litigation and/or damages), but no cost if it continues to use the New Jersey distributor.

A. The Distinctions Relied On By The Third Circuit Do Not Support Its Departure From *Baldwin*, *MITE*, *Brown-Forman*, and *Healy*.

It is well established that "the Commerce Clause . . . precludes the application of a state statute to commerce that takes place wholly outside of the State's borders, whether or not the commerce has effects within the State." *Healy v. The Beer Institute*, 491 U.S. at 336 (quotation omitted). Moreover, as the Third Circuit recognized, the mere fact that the regulated parties have some connection to the state seeking to impose its will on them "does not validate the law if it regulates . . . out-of-state transactions"—even if it is the parties' in-state activities that trigger application of the law. *Brown-Forman*, 476 U.S. at 580; *see also Edgar v. MITE Corp.*, 457 U.S. 624, 641-42 (1982).

The distinction relied upon by the Third Circuit to insulate New Jersey's regulation is a distinction without a difference. The Third Circuit's ruling was based on that court's view that this particular regulation should be considered a rule governing the interpretation of contracts, rather than an independent regulation. But whatever effect may be given to interpretive rules that merely are designed to provide background rules for determining the parties' intent, a different result must obtain where, as here, the state is imposing its own substantive contract terms without regard to an explicit and contrary agreement between the parties. Most if not all of the substantive rules this Court has invalidated as unconstitutional extraterritorial regulations could as easily have been viewed, or drafted, as rules governing the interpretation of contracts. For example, the regulation invalidated in *Baldwin* would have had the same effect if the law had provided that contracts between wholesalers and New York retailers for the purchase of milk include an implied precondition that the wholesaler purchased the milk for a price equal to or greater than a designated

minimum. Similarly, the rules invalidated in *Brown-Forman* and *Healy* could as easily have imposed a term on contracts to sell liquor within the state, setting the price at no higher than the seller is asking in any other state that month.

The Third Circuit's rationale elevates form over substance. The limitations imposed by the Commerce Clause are limits on the power of a state to regulate commerce in other states, and it is immaterial how that power is exercised. *Healy*, 491 U.S. at 336. The Third Circuit's extraordinary ruling to the contrary plainly merits review.

B. The Third Circuit's Rationale Vitiates The Bar Against Extraterritorial Regulation Of Commerce.

The Third Circuit's rationale has no limit. New Jersey happens to have enacted legislation that permits a supplier to disengage from a relationship with a New Jersey distributor (though only if the distributor has materially breached the contract terms). *See* Pet. at 2. But the Third Circuit's treatment of the Commerce Clause question would have been no different if New Jersey had instead simply required all contracts made with New Jersey distributors to continue so long as the distributor remained in business. Under such a law, a multistate contract covering the mid-Atlantic, for example, would remain in effect even if the New Jersey distributor refused to deliver products outside the state, thereby permanently depriving stores and consumers in other states of the supplier's product.

Similarly, under the Third Circuit's rationale, a state could enact a law making all contracts with New Jersey distributors exclusive contracts, even if the parties had bargained for a non-exclusive relationship. Or Kansas could impose, as a contract term, a requirement that all Kansas franchisees must be permitted to veto any license by their franchisor to another franchisee within 25 miles,

even if the proposed licensee operated across the border in Missouri. Kansas franchisees would then be in the enviable position of being able to veto competitors in Missouri. *Cf. Fireside Nissan, Inc. v. Fanning*, 30 F.3d 206 (1st Cir. 1993) (construing a similar state law as not applying extraterritorially).

Nor would such rules necessarily be limited to protecting in-state distributors and franchisees. Under the Third Circuit's rationale, a state with an environmentalist mission could enact a law providing that any contract—written or oral—for sale of a product to an in-state company shall be construed to include a term requiring the seller's manufacturing plant (regardless of location) to comply with prescribed environmental standards. And a state concerned with national employment could enact a rule providing that any contract for sale of a product to an in-state company shall be construed to include the seller's promise that its manufacturing plant is built solely with U.S. materials or uses machinery made solely with U.S. components.

C. The Third Circuit's Rationale Permits A State To Impose Its Policy On Neighboring And Even Distant States.

The Third Circuit's assumption that state law does not violate the Commerce Clause absent a showing that other states impose "inconsistent obligations" is contrary to this Court's decisions and ignores the palpable conflict between rule-based regulation and market-based regulation of commercial activities. Even if New Jersey's rule did not expressly discriminate against would-be distributors and franchisees in other states, it would nonetheless run afoul of the Commerce Clause because it imposes New Jersey's regulatory policy on the sale and distribution of products in other states, without regard for the policies of those states.

The Massachusetts legislature, for example, understandably could be far more concerned with ensuring that its consumers receive the benefit of highly competitive, flexible, and responsive distribution arrangements than with giving distributors a powerful club against suppliers. In addition, in view of that state's many small biotechnology, software and computer companies, which must rely on medical and computer distribution industries dominated by a few huge, multistate companies, the Massachusetts legislature could also be concerned that suppliers are often in a weaker bargaining position than distributors.[2] Further, the Massachusetts legislature could conclude that, even when distributors are in a weaker bargaining position than suppliers, New Jersey's regulation is not a solution; it merely creates a different problem by transferring all power to the distributor. Nonetheless, even if Massachusetts adopted a considered policy to rely on the free marketplace to safeguard its consumers and new industries, New Jersey would override that policy choice in every case where a manufacturer had previously chosen to distribute in Massachusetts through a New Jersey company.

This is the very kind of overreaching the Commerce Clause has long been held to forbid. The Third Circuit's assertion to the contrary—that states may regulate commerce wholly outside their boundaries so long as other states have not adopted rule-based regulations imposing "inconsistent obligations"—warrants immediate review.

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[2] Producers and manufacturers are often smaller and less able to dictate terms than distributors. In some industries—for example, agriculture, music (records, CDs, tapes), magazines, computer equipment and software—this is the norm. Petitioner in this case was a start-up company begun by two Stanford University professors in a garage.

II. THE QUESTION NEEDS TO BE RESOLVED NOW.

Because the Third Circuit's "rule occurs in the commercial context, where advance planning of great precision is most obviously a necessity," [3] it is not appropriate to leave these questions to percolate further in the lower courts. This Court has long recognized that commercial undertakings require clear rules establishing the boundaries of state authority to impose obligations, because a clear rule "encourages settled expectations and, in doing so, fosters investment by businesses and individuals." *Quill Corp. v. North Dakota*, 112 S. Ct. 1904, 1915 (1992).

The decision below affects far more than the parties before that court. Because New Jersey is a major center of regional and national distributors, the decision has far-reaching consequences for interstate commerce and upsets the settled expectations of companies throughout the country, which until this litigation had no reason to expect the New Jersey law would be interpreted to apply extraterritorially, much less that such application would be found consistent with the Commerce Clause.[4]

In addition, nine other states have laws similar to New Jersey's and "[t]he number of states enacting laws restrict-

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[3] *Planned Parenthood v. Casey*, 112 S. Ct. 2791, 2809 (1992) (citations omitted).

[4] New Jersey's location and access to transportation have made it a major distribution center. Not only is New Jersey located close to the major metropolitan areas of New York City and Philadelphia, but it is what is known as a multimodal transportation hub, with access to a major international airport (Newark Airport), a prominent container port (Port Elizabeth), freight trains, and major highways. In addition, peculiarities such as the absence of railroad bridges over the sections of the Hudson River convenient to New York and southern Connecticut—requiring that freight sent by rail from west of the river be broken down or transferred and shipped by truck from New Jersey to points East—have made multi-state distributors based in New Jersey a natural choice for suppliers throughout the country.

ing a franchisor's sale or termination of franchises is rapidly increasing."[5] This development is a matter of concern for "every supplier and distributor of goods and services because these statutes have been held to apply to far more than the traditional fast food hamburger operation."[6] As in New Jersey, many such laws have been interpreted to cover consumer product distributors and even industrial product distributors.[7] At least one of these state laws has already been determined to reach distribution arrangements beyond the state's borders.[8]

Furthermore, the Third Circuit's rationale leaves businesses no opportunity to stabilize their relationships by entering into clear contracts permitting each party to undertake investment and planning decisions with confidence that their agreements will be enforced. Under the Third Circuit's rationale, even the most explicit contractual terms must be disregarded if the state chooses to impose a contrary obligation on one of the parties. Thus, until the decision below is set aside, suppliers cannot make investment and business decisions in reliance on the Commerce Clause to prevent states from regulating commerce wholly outside their borders, and they cannot ensure predictable distribution arrangements through contractual agreements. Accordingly, until this Court resolves the issues presented by the Third Circuit's decision, a broad range of interstate commercial transactions cannot be undertaken with certainty.

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[5] Andre R. Jaglom, "The Broad Scope of Franchise Laws: Traps for the Distribution Contract Drafter," in *Corporate Counsel's Guide to Distribution Counseling* 5.002 (1994).

[6] *Id.*

[7] *Id.*

[8] *See Wilburn & Associates v. Jack Cartwright, Inc.*, Bus. Franchise Guide ¶ 7645 (E.D. Wis. 1979); *L-O Distributors, Inc. v. Speed Queen Co.*, 611 F. Supp. 1569 (D. Minn. 1985) (interpreting Wisconsin law).

Finally, the Third Circuit's contract rationale also gives states a powerful tool for imposing protectionist regulations far beyond their borders. Such rules could involve not only the termination of franchises or distribution arrangements but also any other aspects of those arrangements. Because regional and nationwide distribution arrangements are common in most industries, and dominant in many, such rules would substantially disrupt commerce throughout the nation.[9]

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[9] For example, distribution in the computer and software industry is dominated by three mega-distributors: Ingram Micro, Merisal, and TechData. Far from a highway hamburger stand or a neighborhood copy shop, Merisal grossed $3.1 billion in sales in fiscal 1993 and projected $5 billion in fiscal 1994. Computer Reseller News, Mar. 14, 1994, at 37. Similarly, those involved in pharmaceuticals have observed the growing consolidation of the pharmaceutical distribution industry, and predict: "In a few years there are going to be a few big wholesalers that will control the industry." Chain Drug Review, Nov. 2, 1994, at 22 (statement by Alan Glenn of Drug Guild, the ninth largest distributor). Similarly, industries as diverse as office products and music (records, tapes, CDs) are increasingly relying on multistate and even national distributors. *See* The Buffalo News, Sept. 5, 1993 (article on BasicNet, formed by the merger of 32 office products distributors); Billboard, Sept. 11, 1993, at 51 (discussing the growing reliance on national distributors).

CONCLUSION

The petition for a writ of certiorari should be granted.

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BRIEF OF THE STATE OF NEW HAMPSHIRE AS AMICUS CURIAE IN SUPPORT OF THE PETITIONER

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ISSUE PRESENTED

1. Whether the Third Circuit has misconstrued the analytical principles established by this Court for evaluation of a facially neutral state economic regulation with extraterritorial effect under the federal Commerce Clause in *Pike v. Bruce Church, Inc.*, 307 U.S. 131 (1970) by refusing to consider the effects of New Jersey's Franchise Practices Act on commerce in states outside New Jersey.

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CONSTITUTIONAL AND STATUTORY PROVISIONS

1. The Commerce Clause provides that "The Congress shall have Power ... to regulate Commerce with foreign Nations, and among the several States." *U.S. Const., Art. I, § 8, cl. 3.*

2. The relevant provision of the New Jersey Franchise Practices Act, *N.J. Stat.* §§ 56:10-1 *et seq.* (1993), is Section 5 of the statute, *N.J. Stat.* § 56:10-5, which provides in pertinent part:

> "It shall be a violation of this act for a franchisor to terminate, cancel or fail to renew a franchise without good cause. For the purposes of this act, good cause for terminating, cancelling, or failing to renew a franchise shall be limited to failure by the franchisee to substantially comply with those requirements imposed on him by the franchise."

INTEREST OF THE AMICUS

The Amicus herein is the Attorney General of the State of New Hampshire. The Attorney General is charged with both common law and statutory power to take legal action in the public interest. The present case concerns the application of a New Jersey statute governing franchise termination which may have the effect of preventing school districts in New Hampshire that have purchased, or may be considering the purchase and installation of the Petitioner's interactive computer learning systems from transacting business directly with Petitioner, a California company.

Specifically, the decision of the Third Circuit to uphold under the federal Commerce Clause provisions of the New Jersey Franchise Practices Act ("NJFPA"), *N.J. Stat.* §56:10-5 (1993), which require Petitioner to renew its distributorship agreement with its New Jersey-based distributor for an indefinite period beyond the expiration of the agreement, may have the result of imposing additional costs and burdens on New Hampshire school systems which may have an interest in acquiring Petitioner's learning systems./1/ The State of New Hampshire believes it to be in

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/1/ The State has been informed that, since 1989, Petitioner has sold, installed and currently provides services related to two interactive learning systems at a high school and junior high school located in Nashua, New Hampshire at a cost to the Nashua school system of approximately $200,000.00. It appears undisputed that no system sales were made in New Hampshire by Instructional Systems, Inc. ("ISI") during the effective period of its distributorship agreement with Petitioner.

the public interest to call such effects of the application of New Jersey law on New Hampshire school districts and their constituent students to the attention of this Court.

In particular, the State of New Hampshire notes that the analytical framework applied by the Third Circuit in upholding the state economic regulation at issue in this case against Commerce Clause challenge failed to include any analysis of the effect of that regulation on commerce within and involving New Hampshire and other states. Because New Hampshire views this failure to examine issues of direct relevance to this and other states as contrary to precedent of this Court and in conflict with the mode of analysis used in the First Circuit to review New Hampshire's own dealership regulation statute under the Commerce Clause, the Attorney General asserts a direct interest in this litigation and urges the Court to grant Petitioner's Writ of Certiorari.

SUMMARY OF ARGUMENT

The State of New Hampshire supports the Petitioner's request that this Court grant a Writ of Certiorari to determine the proper analytic framework for evaluating state economic regulation which has significant extraterritorial effect under the Commerce Clause of the United States Constitution, *U.S. Const., Art I, § 8, cl. 3*, in view of a developing conflict among the Circuits.

This case presents a clear opportunity for this Court to provide guidance to the Circuits regarding the vitality of the balancing test established by *Pike v. Bruce Church, Inc.*, 307 U.S. 131 (1970) for analysis of state economic regulation with extraterritorial effect under the Commerce Clause. The State believes that such guidance is necessary (i) to create uniformity of treatment of state economic regulation under the Commerce Clause and (ii) to ensure that the interests, not only of the state whose regulation is under challenge, but of all states effected by such regulation, are considered in the context of Commerce Clause challenges to state regulation.

The Third Circuit based its ruling that the franchise termination provisions of the New Jersey Franchise Practices Act ("NJFPA"), *N.J. Stat.* §56:10-5 (1993) do not offend the Commerce Clause *solely* on its determination that the statute as written is facially neutral. In doing so, the Third Circuit has misconstrued the analytical principles established by this Court in *Pike v. Bruce Church, Inc.* and reaffirmed in such cases as *Edgar v. MITE Corp.*, 457 U.S. 624 (1982) (plurality opinion). Rather, the State believes that the extraterritorial effect of facially neutral state economic regulation such as the NJFPA franchise termination provision is properly evaluated by the balancing of local interests

protected by such regulation against the burden on interstate commerce imposed by the regulation. *Edgar v. MITE Corp.*, 457 U.S. at 643; *Pike v. Bruce Church, Inc.*, 397 U.S. at 142. *See also, CTS Corp. v. Dynamics Corporation of America*, 481 U.S. 69, 94 (1987).

Moreover, had the Third Circuit reviewed the effects on interstate commerce imposed by the NJFPA as applied in this case, it would have been required to note the effect on commerce within New Hampshire and other states in which Petitioner currently does business directly with local school districts. The effect of refusing to review such consequences is to allow the NJFPA's extraterritorial reach to stand without any consideration of the potentially significant economic consequences to New Hampshire's school districts and school children which may result from application of that statute to limit Petitioner's ability to conduct business directly in New Hampshire with New Hampshire citizens.

Finally, precisely these principles have been used in the First Circuit to limit the scope of New Hampshire law regulating the relations between automobile manufacturers and dealers. *New Hampshire Automobile Dealers Association, Inc. v. General Motors Corporation*, 801 F.2d 528, 532 (1st Cir. 1986). Both elementary fairness and the national interest in uniform application of federal law dictate that New Hampshire's citizens should be protected by the Commerce Clause to the same extent and under the same principles as its laws are subject to federal scrutiny. Therefore, this Court should grant Petitioner's request for a Writ of Certiorari.

REASONS FOR GRANTING THE WRIT

I. THE WRIT SHOULD BE GRANTED BECAUSE THE THIRD CIRCUIT'S DECISION IS IN CONFLICT WITH DECISIONS OF THIS COURT AND OF COURTS IN SEVERAL OTHER CIRCUITS CONCERNING THE PRINCIPLES TO BE APPLIED TO COMMERCE CLAUSE ANALYSIS OF THE EXTRATERRITORIAL EFFECT OF FACIALLY NEUTRAL STATE ECONOMIC REGULATION

The State of New Hampshire believes that the Writ should be granted to provide guidance to the Circuits concerning the proper analytic framework for evaluating facially neutral state economic regulation with extraterritorial effect under the Commerce Clause.

It is a fundamental principle of this Court's jurisprudence under the Commerce Clause that state economic regulations may not be applied in a manner that directly regulates commerce outside of its borders. *Healy v. Beer Institute*, 491 U.S. 324, 336-37, (1989); *Edgar v. MITE Corp.*, 457 U.S. at 643; *City of Philadelphia v. New Jersey*, 437 U.S. 617, 628 (1978). At the same time,

> "not every exercise of state power with some impact on interstate commerce is invalid. 'A state statute must be upheld if it regulates even-handedly to effectuate a legitimate local public interest and its effects on interstate commerce are only incidental ... unless the burden imposed on such commerce is

clearly excessive in relation to the putative local, benefits.'"

Edgar v. MITE Corp., 457 U.S. at 640, quoting *Pike v. Bruce Church, Inc.*, 397 U.S. at 142. "If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities." *Pike v. Bruce Church*, 397 U.S. at 142.

In effect, these principles dictate that state economic regulations which purport to directly regulate trade or commerce outside the borders of the enacting state are *per se* invalid under the Commerce Clause. *See, e.g., Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27, 36-37 (1980); *City of Philadephia v. New Jersey*, 437 U.S. at 624. However, regulations which are facially non-discriminatory -- i.e., which do not explicitly impose greater burdens on interstate than intrastate commerce -- are subject to the balancing test established by *Pike v. Bruce Church. CTS Corp. v. Dynamics Corp. of America*, 481 U.S. at 94; *Edgar v. MITE Corp.*, 457 U.S. at 640.

This is the rule by which the extraterritorial effect of New Hampshire's statute regulating the relationships between automobile manufacturers and dealers has been analyzed by the First Circuit. *New Hampshire Automobile Dealers Association, Inc. v. General Motors Corp.*, 801 F.2d 528, 532 (1st Cir. 1986) (construing restrictions on differential pricing to exclude sales to rental agency in order to avoid excessive

burden on commerce in other states)[2]; *see also, Hyde Park Partners, L.P. v. Connolly*, 839 F.2d 837, 844 (1st Cir. 1988) (invalidating Massachusetts corporate anti-takeover law under *Pike* test). A similar rule applies in the majority of federal circuits. *See, e.g., Medigen of Kentucky, Inc. v. Public Service Commission*, 985 F.2d 164, 166-67 (4th Cir. 1993); *ANR Pipeline Co. v. Schneidwind*, 801 F.2d 228, 237-38 (6th Cir. 1986), *aff'd* 485 U.S. 293 (1988); *Pioneer Military Lending, Inc. v. Manning*, 2 F.3d 280, 283 (8th Cir. 1993); *Pacific Northwest Venison Producers v. Smitch*, 20 F.3d 1008, 1012 (9th Cir. 1994), *cert. denied*, 115 S.Ct. 297 (Oct 3, 1994) (No. 94-20); *Dorrance v. McCarthy*, 957 F.2d 761, 764 (10th Cir. 1992); *Diamond Waste, Inc. v. Monroe County*, 939 F. 2d 941, 944-45 (11th Cir. 1991).

In upholding the operation of the NJFPA in this case, the

/2/ In *New Hampshire Automobile Dealers*, Judge Breyer, writing for the Court, upheld the construction of a New Hampshire statute forbidding differentials in manufacturers' pricing to auto dealers as inapplicable to "fleet" sales by General Motors to car rental agencies with limited public sales programs. *Id.* at 532-33. In so ruling, the Court noted that a reading of the statute which applied to such sales could violate the Commerce Clause. The Court cited four factors which supported this position: (i) the statute's potential effect on General Motors prices to "fleet" purchasers outside of New Hampshire; (ii) its potential limitation of access by out-of-state manufacturers to New Hampshire consumers; (iii) its potential limitation of access by New Hampshire consumers to out of state sources of General Motors products; and (iv) the protectionist nature of the statute at issue. *Id.* at 532.

Third Circuit has departed from this traditional analysis. First, the Third Circuit ruled that, because the NJFPA's franchise termination provision is facially neutral, it is not *per se* invalid under the Commerce Clause. However, the Third Circuit then ruled that, in balancing the local benefits of the NJFPA against any incidental burden on interstate commerce under *Pike*, it should examine only the effect of the statute on "interstate commerce," and not on commerce as actually conducted in the several states effected by the franchise termination provision. *Opinion of the Court, Petitioner's Appendix ("Appendix")* 27a:

> "[W]e do not look at the effect of the state regulation on the commerce of other states when we balance [under *Pike*]. Instead ... the only incidental burdens on interstate commerce that implicate the commerce clause ... are those that discriminate against interstate commerce."

Opinion of the Court, Appendix, 27a (Citations omitted). The Court then reasoned that, because the statute was facially neutral and did not overtly discriminate against interstate commerce, it imposed no burden on interstate commerce and would be upheld. *Opinion of the Court*, 28a.[3]

/3/ The State does not support all aspects of the Petitioner's challenge to the reasoning of the Third Circuit. Petitioner would have this Court rule the NJFPA *per se* invalid simply by virtue of its extraterritorial reach. *Petition For Writ of Certiorari ("Petition")*, 9-15. The State does not share in Petitioner's contention that facially neutral state law applied in a manner which has incidental effects on commercial (cont'd)

By so holding, the Third Circuit has, in effect, misapplied the *Pike* balancing test. The Third Circuit's test is deficient in that it imports the traditional test for *per se* invalidity of state law into the *Pike* balancing analysis by suggesting that a facially neutral statute can have no cognizable effect on interstate commerce. *Opinion of the Court, Appendix*, 28a. Adoption of such a standard under *Pike* would have the effect of legitimizing any facially neutral state law which, as applied, would effect commerce in other states, without regard to the effect of such a statute on commercial activity occurring beyond the borders of the enacting state. This result is plainly inconsistent with the policy of promoting a national economy which undergirds this Court's dormant Commerce Clause jurisprudence. *See, e.g. City of Philadelphia v. New Jersey*, 437 U.S. at 624; *H.P. Hood & Sons, Inc. v. Du Mond*, 336 U.S. 525, 537 (1949); *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 527 (1935).

As applied in this case the NJFPA will directly regulate the terms and conditions by which New Hampshire purchasers may acquire Petitioner's products by forbidding direct marketing of products by the Petitioner to existing or potential school district-buyers in New Hampshire. The mere

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(Footnote 3, cont'd)

activity beyond its borders must be ruled *per se* invalid as so applied. Rather, the State asserts that any such statute is properly measured by the balancing analysis of *Pike* and should be upheld unless it places a clearly excessive burden on interstate commerce in relation to the local benefits conferred. *Pike v. Bruce Church, Inc.*, 397 U.S. at 142.

fact the purchasers in New Hampshire will be required to obtain Petitioner's products through a dealer, presumably at a markup in price, establishes that there is some burden on commerce in New Hampshire effected by the application of the NJFPA. Higher prices for Petitioner's system in New Hampshire could result in greater financial burdens on school systems and their taxpaying residents or in the decision by a school system to forego the expenditure necessary to acquire Petitioner's system.

It is these effects on "commerce of other states" that the Third Circuit should have examined when reviewing the propriety of the NJFPA under the Commerce Clause. *Pike v. Bruce Church, Inc.*, 307 U.S. at 142. By adopting too permissive a test for facially neutral legislation, the Third Circuit has deviated from the precedent of this Court. In addition, the Court ignored the effects that extraterritorial application of the NJFPA may have on the rights of citizens of states other than New Jersey to freely engage in interstate transactions.

By so arguing, the State does not suggest that the mere possibility of incidental market effects occuring beyond a state's border is sufficient to support a challenge to the validity of a state regulation or enactment. *See, e.g., CTS Corp. v. Dynamics Corporation of America,* 481 U.S. at 94. However, where, as here, the effect of a statute is to expressly permit or forbid the conduct of specific transactions between the citizens of states other than the enacting state, then such an effect on commerce outside the enacting state is germane to the question of whether the statute is permissible under *Pike*.

Ordinarily, the question of whether a statute which effectively regulates transactions occurring in commerce

beyond the borders of the enacting state imposes a clearly excessive burden on interstate commerce will be one of fact. Thus, under *Pike*, the Petitioner should have the opportunity to demonstrate that the statute imposes such a burden by demonstrating the necessary effect of applying the statute, as construed, on transactions occurring beyond New Jersey. *See Pike v. Bruce Church, Inc.,* 397 U.S. at 142. By declaring the effects of the NJFPA on commerce in New Hampshire and other states irrelevant to its analysis under *Pike*, the Third Circuit has essentially instructed the District Court on remand to exclude such issues from its factual analysis.

Such a result effectively deprives the citizens of New Hampshire of the benefit of protection under the Commerce Clause. Elementary considerations of fairness, as well as the national interest in uniform application of federal law dictate that New Hampshire's citizens should be accorded the protections of the Commerce Clause under the same principles as are applicable to the consideration of its own laws. *See, New Hampshire Automobile Dealers Association, Inc. v. General Motors Corp.*, 801 F.2d at 532 (1st Cir. 1986). Therefore, the State urges this Court to grant Petitioner's request for a Writ of Certiorari in this matter for the purpose of elucidating the proper analytical standard for evaluating state economic regulation under the Commerce Clause.

CONCLUSION

The Commerce Clause at its most basic level stands for the principle that "our economic unit is the Nation." *H.P. Hood & Sons, Inc. v. DuMond*, 336 U.S. at 537; *see also, City of Philadelphia v. New Jersey*, 437 U.S. at 624; *New Hampshire Automobile Dealers v. General Motors*, 801 F.2d at 532. This Court and most federal Circuits have established the validity and utility of the balancing test enunciated in *Pike v. Bruce Church, Inc.* for analysis of facially neutral state economic regulation under the Commerce Clause. The analysis adopted by the Third Circuit has essentially repudiated that test, and by doing so, has ignored the effect of the NJFPA on commerce within New Hampshire. The Third Circuit's analysis is also inconsistent with the principles applicable to New Hampshire's own statutory enactments within the First Circuit. Therefore, this Court should grant Petitioner's request for a Writ of Certiorari.

Respectfully Submitted,

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No. 94-1033

IN THE

Supreme Court of the United States

October Term, 1994

COMPUTER CURRICULUM CORPORATION,

Petitioner,

v.

INSTRUCTIONAL SYSTEMS, INC.,
and
DEBORAH T. PORITZ, ATTORNEY GENERAL
OF THE STATE OF NEW JERSEY,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF OF COMPUTING TECHNOLOGY INDUSTRY ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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January 17, 1995

MOTION OF COMPUTING TECHNOLOGY INDUSTRY ASSOCIATION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE*

The Computing Technology Industry Association ("CompTIA" or "Association") respectfully moves this Court for leave to file the attached brief *amicus curiae* in support of the petition for writ of *certiorari*. The consent of the petitioner has been obtained.* The consent of respondent Instructional Systems, Inc. has been refused. The consent of respondent Deborah T. Poritz, Attorney General of the State of New Jersey, has been sought but has not been granted.

CompTIA is a national not-for-profit association of more than 6,100 microcomputer distributors, manufacturers, resellers, software publishers, and service companies. Its mission is to foster high levels of professional competence and business ethics among its members and throughout the computer industry. Combined sales of member companies reached $50.5 billion in 1993. Total industry-wide microcomputer sales in 1993 in the United States were estimated at $81.7 billion.

The Association's members have a vital interest in the instant case. The Third Circuit's decision poses a significant threat to the ability of suppliers and distributors in the computer industry to decide for themselves the terms on which they will do business throughout the Northeast region and even the entire country.

The practical implications of the decision below for the multibillion-dollar microcomputer industry are enormous.

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* The letter reflecting such consent to the submission of this brief has been filed with the Clerk of the Court.

CompTIA is well situated to assist the Court by alerting it to the practical dangers of extraterritorial application of statutes like the New Jersey Franchise Practices Act. The Association therefore respectfully moves this Court for leave to file the attached brief *amicus curiae*.

Respectfully submitted,

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January 17, 1995

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INTEREST OF *AMICUS CURIAE*

Amicus curiae the Computing Technology Industry Association ("CompTIA" or "Association") submits this brief in support of the petition for writ of *certiorari*. As discussed in the accompanying motion for leave to file, the Association and its more than 6,100 members have a vital interest in this case.

INTRODUCTION AND SUMMARY OF ARGUMENT

This Court has always stressed that the touchstone of dormant Commerce Clause analysis is a law's "practical effect." *E.g.*, *Brown-Forman Distillers Corp. v. New York State Liquor Auth.*, 476 U.S. 573, 583 (1986). The practical effect of the New Jersey Franchise Practices Act, N.J. Stat. Ann. § 56:10-1, *et seq.* ("NJFPA"), as authoritatively construed by the New Jersey Supreme Court, is to disrupt commerce wholly outside New Jersey. Any distribution arrangement with a New Jersey-based distributor is now at risk of being subject to the draconian provisions of the NJFPA even insofar as it relates to *other* States. If the Court of Appeals' decision is permitted to stand, manufacturers that have retained New Jersey-based distributors may find that they are forbidden from changing their method of distribution — in perpetuity — not only in New Jersey, but throughout an entire region or (if the agreement was a nationwide one, which is not uncommon) throughout the entire country.

Moreover, although most States, as well as Congress, have refused to adopt franchise protection statutes for fear of their anti-competitive impact, New Jersey is not the only State with such a law. Several other States — including Wisconsin, Illinois, and Iowa — have similar statutes compelling renewal of franchise or dealership arrangements absent good cause for nonrenewal. The decision below would permit these States, as well as others, to

project their laws extraterritorially in order to rewrite private contracts between distributors and suppliers. Individual States could interfere with interstate commerce on a regional or even national basis.

There are further reasons that this case is of special concern to the computer industry. The New Jersey Supreme Court made clear that agreements between computer manufacturers and distributors are a vulnerable target of franchise termination statutes. The court singled out the close relationship between computing technology suppliers and distributors as exhibiting the "hallmark of the franchise relationship" regulated by the NJFPA. Pet. App. 128a (citation omitted).

Yet there is probably no industry in which it is more important to avoid freezing companies into particular distribution methods by statute. Many hardware and software products on the market today could not have been foreseen only a few years ago. Trends in consumer needs and tastes are equally unpredictable. Accordingly, distribution arrangements — particularly multistate arrangements, which are quite common in the computer industry — must remain flexible. Indeed, modes of distribution in the computer industry are themselves the subjects of rapid change, as lines blur among distributors, franchisors, and franchisees. Market forces are stimulating the development of diverse and innovative methods of distribution on a nationwide basis.

It would be unthinkable to attempt legislatively to freeze business relationships as they exist today. But the NJFPA purports in effect to do just that, by ignoring the parties' own negotiated agreements and bestowing franchises that are by law potentially infinite in duration. The NJFPA does so extraterritorially, on a regional or even nationwide basis.

Hence, respondent ISI's claim in its opposition that "[t]his case has no significance to anyone except ISI and CCC," Opp. Cert. at 15 (quoting argument heading), is completely false. The entire multibillion-dollar computer industry has a vital interest in this case. Other industries do as well, since the scope of the NJFPA and the logic of the decision below cannot be confined to computing technology. Indeed, even distributors have a stake in reversing the decision below: the NJFPA's interference with interstate commerce may work to ISI's benefit in this particular dispute, but it does not advance the interests of distributors overall. If a supplier cannot ensure that a State will honor the supplier's freely negotiated contracts with distributors, it will demand a "risk premium" — such as a higher price — to compensate for the uncertainty it faces, or simply forgo entering into what otherwise might be a mutually advantageous business relationship. Accordingly, leading distributors within the Association voted to file this brief urging this Court to grant the petition for *certiorari*, even though distributors are ostensibly beneficiaries of the New Jersey statute.

REASONS FOR GRANTING THE WRIT

This Court has repeatedly stressed that the dormant Commerce Clause is concerned with, above all else, the *practical effect* of a state law. In the context both of *per se* unlawful extraterritorial laws and of burdens on commerce governed by *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970), "the critical consideration is the overall effect of the statute on both local and interstate activity." *Brown-Forman Distillers Corp. v. New York State Liquor Auth.*, 476 U.S. 573, 579 (1986). A law is *per se* invalid if its "practical effect" is "to control [commerce] in other States." *Id.* at 583; *see Healy v. The Beer Institute*, 491 U.S. 324, 336 (1989) ("[t]he critical inquiry is whether the practical effect of the regulation is to control conduct beyond the boundaries of the State"); *Southern Pacific Co. v. Arizona ex rel. Sullivan*, 325 U.S. 761, 775 (1945)

(invalidating law whose "practical effect . . . is to control [conduct] beyond the boundaries of the state").[1]

The practical effect of the NJFPA is to disrupt interstate commerce by regulating, and potentially prohibiting, transactions wholly outside New Jersey. According to the decision below, for example, a manufacturer doing business with a New Jersey distributor could be enjoined, in perpetuity, from changing its methods of distribution in other States. This would be true even if the goods never pass through New Jersey.

If other States were to follow New Jersey's example of projecting state law extraterritorially to nullify contracts among manufacturers, distributors, and resellers, "the free movement of [goods] in the stream of commerce will be severely impaired" — a process that could "result in the type of balkanization the Clause is primarily intended to prevent." *C&A Carbone, Inc. v. Town of Clarkstown*, 114 S. Ct. 1677, 1690 (1994). "This kind of potential regional and even national regulation" of distribution activities "is reserved by the Commerce Clause to the Federal Government and may not be accomplished piecemeal through the extraterritorial reach of individual state statutes." *Healy*, 491 U.S. at 340.

This threat is not hypothetical. Some eighteen other States have adopted franchise termination statutes,[2] although most are not as

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[1] *See also C&A Carbone, Inc. v. Town of Clarkstown*, 114 S. Ct. 1677, 1684 (1994); *Wyoming v. Oklahoma*, 112 S. Ct. 789, 791 (1992); *Trinova Corp. v. Michigan Dept. of Treasury*, 498 U.S. 358, 372 (1991); *Goldberg v. Sweet*, 488 U.S. 252, 260 (1989); *Lewis v. B.T. Inv. Mgrs., Inc.*, 447 U.S. 27, 37 (1980).

[2] *See* Ark. Code Ann. § 4-72-204; Cal. Bus. & Prof. Code § 20020; Conn. Gen. Stat. Ann. § 42-133f(a); Del. Code Ann. tit. 6, § 2552; D.C. Code. Ann. § 29-1203; Haw. Rev. Stat. § 482E-6; Ill. Rev. Stat. ch. 815, ¶ 705, § 19 & ¶ 710, § 9; Ind. Code Ann. § 23-2-2.7-1; Iowa Code Ann. §§ 523H.1-523H.17; Mich. Comp. Laws Ann. § 445.1527; Minn. Stat. Ann. § 80C.14; Miss. Code Ann. § 75-24-53; Mo. Ann. Stat. § 407.405; Neb. Rev. Stat. § 87-404; N.J. Stat. § 56:10-15; P.R. Laws Ann. tit 14, § 278a;

onerous as the NJFPA.[3] Under the decision below, all of these statutes could be projected extraterritorially, producing a crazy-quilt pattern of state regulation that the Commerce Clause was surely intended to prevent. A supplier's only recourse would be to avoid entering into distribution arrangements with companies based in New Jersey and other States with similar laws. But forcing suppliers to protect themselves by forgoing otherwise profitable business opportunities is itself inefficient and would have a significantly anti-competitive effect on the delivery of goods into other States. In the end, suppliers, distributors, and consumers — even consumers who do not live in States that have such laws — would all be harmed. Moreover, for those suppliers that have existing relationships with distributors located in New Jersey or States with comparable laws, it may already be too late.

The multibillion-dollar computer industry, which is expected to play an increasingly vital role in the national economy in the coming years, is particularly vulnerable to such extraterritorial regulation. Most distributors operate on a multistate basis, serving many dealers throughout the United States. This interstate activity creates the danger that States like New Jersey would be able to justify applying their franchise termination statutes extraterritorially to multistate contracts involving distributors doing business within the

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Tenn. Code Ann. §§ 47-25-1503 to 1504; Va. Code Ann. § 13.1-564; V.I. Code Ann. tit. 12a, § 132; Wash. Rev. Code Ann. § 19.100.180; Wis. Stat. Ann. § 135.03.

[3] Seven of these States distinguish between termination and renewal — allowing non-renewal of franchise agreements with no "good cause" requirement — or require merely that notice be given prior to non-renewal or termination. *See* Cal. Bus. & Prof. Code § 20020; Mich. Comp. Laws Ann. § 445.1527; Minn. Stat. Ann. § 80C.14(3)-(4); Miss. Code Ann. § 75-24-53; Mo. Ann. Stat. § 407.405; Va. Code Ann. § 13.1-564; Wash. Rev. Code Ann. § 19.100.180(2)(i)-(j); *see also* Ind. Code Ann. § 23-2-2.7-1 (requiring good cause for non-renewal but also providing that statute "shall not prohibit a franchise agreement from providing that the agreement is not renewable upon expiration"); Neb. Rev. Stat. § 87-404 (same).

State. Indeed, the New Jersey Supreme Court asserted that, "[b]ecause of the extraordinary and intricate relations that arise in the distribution of computer products, a 'close symbiotic relationship' arises almost of necessity between manufacturers and distributors or resellers." Pet. App. 127a-128a. According to the New Jersey court, such a "symbiotic relationship" between suppliers and distributors is the "hallmark of the franchise relationship," *id.* at 128a (internal quotation omitted) — leading the court to "adapt" legislation enacted on the model of a typical fast-food franchise "to the rapidly-evolving complexities of the computer industry and its various distribution channels." *Id.* at 85a.

Yet the kind of extraterritorial regulation upheld by the Third Circuit would severely disrupt the highly dynamic computer industry. The NJFPA would freeze existing distribution arrangements in place and would strip computer manufacturers, distributors, resellers, and other companies of the flexibility they need to adapt to market changes. Manufacturers, which are often forced (particularly in the early stages of a product's life cycle) to enter into exclusive distribution arrangements, could find themselves bound to one distributor potentially in perpetuity.

This extraterritorial, legislatively enforced rigidity would be disastrous for the computer industry. As a leading industry consultant has observed, "the reseller channel is continually in flux":

> The reality of today's computer industry is that three months can make a liar out of anyone. One bad quarter can send a company's stock and management into the cellar. . . . We have to make intelligent statements about products we have read about but that don't really exist yet. We must make strategic decisions for many consumers that are no more than a wing and a prayer, plus some new technology that will be available in the next quarter.

Susan Spiner, *The Reseller Saga Continues: Crystal Ball Gazing for '94 — the Market Comes Full Circle*, Computing Channels 14 (Dec. 1993). Another commentator has written that "[e]ven the casual observer quickly realizes that constant change is perhaps the only generalization possible regarding distribution channels for computer products." Miles R. Gilburne, *The Granting of Marketing Rights Early in the Product Life Cycle of Hardware and Software: The Problem of Distribution Channel Lock-In*, Computer Lawyer 28 (Feb. 1994). "Given the fragility of distribution practices which may exist at any given time in the computer industry, it is not possible to predict with any certainty what distribution practices will be desirable in even the relatively near term." *Id.* at 32. Accordingly, distribution arrangements "must be structured in such a manner as to maximize future flexibility in what is likely to be an extremely fluid market." *Id.*

The dynamic nature of distribution arrangements in the computer industry is underscored by recent developments blurring the lines among the traditional market roles. For example, the industry's second largest distributor, Merisel, recently acquired a franchisor organization, Computerland, and now plays a dual role in the market. Other franchisors are finding that they can no longer thrive simply as name brand product suppliers. To expand their business, many have added services traditionally offered only by distributors, like lending money to franchisees to finance inventory. Large-format retailers like computer superstores, office product superstores, and warehouse membership clubs, are now viable independent avenues of distribution. Direct sales by manufacturers similarly avoid traditional distribution channels altogether.

Perhaps the most dramatic development is the increasing availability of the computer modem, which enables software companies to disseminate their products electronically to consumers, without the need for the physical transport and delivery of goods that historically have characterized distribution activities. Under

the decision below, however, a supplier with a contractual relationship with a traditional distributor might be inhibited from using the modem to distribute software cheaply and efficiently to consumers — even if the parties expressly preserved in their contract the supplier's right to alter distribution methods in response to market forces and technological change.

In short, the computer industry is changing and consolidating, both technologically and organizationally. Creative approaches are a necessity in the high-volume, low-margin business of distributing small quantities of goods frequently to many different small customers. Any legislative attempt to interfere with the private decisions of companies in the marketplace will hamper efficiency and ultimately injure consumers. Even distributors — the ostensible beneficiaries of franchise termination statutes like the NJFPA — will be harmed, as manufacturers will simply forgo entering into relationships with them or will demand higher prices to compensate the manufacturers for the risk that they might unwittingly become locked into existing distributor channels.

For all these reasons, the extraterritorial state regulation upheld by the Third Circuit threatens to distort dramatically the interstate distribution of goods and services in the computer industry and to disrupt severely commerce occurring wholly outside New Jersey.

CONCLUSION

The petition for writ of *certiorari* should be granted.

Respectfully submitted,

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No. 94-1033

IN THE
Supreme Court of the United States

October Term, 1994

COMPUTER CURRICULUM CORPORATION,

Petitioner,

v.

INSTRUCTIONAL SYSTEMS, INC.
and
DEBORAH T. PORITZ, ATTORNEY GENERAL
OF THE STATE OF NEW JERSEY,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

REPLY BRIEF OF PETITIONER

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REPLY BRIEF OF PETITIONER

As we explained in the Petition, the court of appeals upheld extraterritorial application of the New Jersey Franchise Practices Act, N.J. Stat. § 56:10-1, *et seq.* ("NJFPA"), to regulate commerce wholly outside New Jersey. In doing so, the court of appeals provided States with a blueprint for evading the Commerce Clause's *per se* prohibition on extraterritorial state regulation, *see Healy* v. *Beer Institute*, 491 U.S. 324, 336 (1989); *Brown-Forman Distillers Corp.* v. *New York State Liquor Auth.*, 476 U.S. 573, 582-83 (1986), based on the court of appeals' unsupportable assertion that "it is the parties' own agreement"—not the State of New Jersey—"which operated to project the New Jersey law outside of New Jersey's borders." Pet. App. 25a. In addition, the court of appeals, applying what is now settled law in the Third Circuit, eviscerated the test of *Pike* v. *Bruce Church, Inc.*, 397 U.S. 137 (1970), by holding that a state law's impact on commerce in other States should not be considered if the law can be described as "facially neutral." Pet. App. 27a-28a. We showed—and neither respondent disputes—that lower courts are divided over these important questions.

The Oppositions to *certiorari* filed by Instructional Systems, Inc. ("ISI") and the New Jersey Attorney General (the "Attorney General") only underscore the need for this Court's review.

1. ISI, but not the Attorney General, argues that this Court cannot decide the questions presented because they were supposedly "not presented in the record in the court of appeals." Opposition of Respondent ISI ("ISI Opp.") 7. This is simply untrue. This case is about nothing *but* New Jersey's power to apply the NJFPA extraterritorially to compel an out-of-state supplier to renew the parties' agreement, potentially in perpetuity, in States outside New Jersey, and to make it illegal for the supplier to sell its products directly to consumers in those States. Whether, as a matter of law, such application of the NJFPA violates the Commerce Clause is the issue on which CCC moved for summary judgment, Pet. App. 32a-33a; it is the issue the district court decided ("The extraterritorial application of the Franchise Practices Act is a *per se* violation of the Commerce Clause," Pet. App. 60a); it is the issue which ISI sought to certify

to the court of appeals ("whether the [NJFPA], *per se* or as applied to the [parties' 1984] Reseller Agreement . . . violates the Commerce Clause," J.A. 1911); it is the issue reviewed by the court of appeals (whether the "statute violates the dormant Commerce Clause when applied to activities of a New Jersey franchise outside New Jersey," Pet. App. 21a); and it is the issue decided by the Court of Appeals: "we see no facial conflict between the NJFPA and the dormant Commerce Clause." *Id.* at 26a. There can be no doubt that the Commerce Clause question is properly before this Court.[1/]

ISI, however, makes the remarkable claim that, as a result of the abstention proceedings in this case, the court of appeals' decision of the Commerce Clause question rested on the full faith and credit statute, 28 U.S.C. § 1738, or the doctrine of *Rooker* v. *Fidelity Trust Co.*, 263 U.S. 413 (1923), and *District of Columbia Court of Appeals* v. *Feldman*, 460 U.S. 462 (1983). *See* ISI Opp. 6, 10–12. That is not so. The court of appeals specifically *rejected* ISI's argument that the state court ruling was preclusive on the Commerce Clause question. Pet. App. 15a–18a. It held that "it is clear from the record" that—as ISI had conceded in the district court—CCC properly reserved the Commerce Clause question, pursuant to *England* v. *Louisiana State Bd. of Medical Examiners*, 375 U.S. 411 (1964). Pet. App. 16a. The court of appeals held that the state-court proceeding was preclusive only with respect to "the state law issues." *Id.* at 20a.[2/]

[1/] The Attorney General makes the erroneous assertion that CCC's Petition has "abandoned" any *per se* challenge to extraterritorial application of the NJFPA. Opposition of New Jersey Attorney General ("NJ Opp.") 13, 14. As the Petition makes clear (at 3, 7, 9–11), CCC expressly relies on the *per se* standard and seeks review because the Third Circuit's decision "directly conflicts with this Court's decisions interpreting the Commerce Clause as imposing a *per se* ban on extraterritorial state regulation." Pet. 9.

[2/] In fact, the earlier abstention proceedings make this case unusually well suited for this Court's review. The New Jersey Supreme Court's decision removes any concern that the constitutional question is being reached before the state courts have had an opportunity to construe the statute more narrowly. The state's highest court has authoritatively declared that it is the policy of New Jersey, as

(continued...)

2. Employing the same legal fictions as those used by the court of appeals, ISI argues that extraterritorial application of the NJFPA was the product of "the parties' volitional action, not state law." ISI Opp. 6. But the argument of the Attorney General of New Jersey shows otherwise.

The Attorney General asks this Court to recognize "[t]he power of every State, reposed not only in its legislature, but also in its judiciary, to act protectively on behalf of its citizens," even when that protection involves the regulation of commerce wholly outside the State. N.J. Opp. 23. To the Attorney General, the terms of a contract should not be "immune from alteration in the public interest." *Id.* at 22. Here, the parties' agreement that California law would govern and that the contract would expire on July 31, 1989 must be revised because it is "contrary to public policy." *Id.* at 23. The Attorney General maintains that a State must be permitted to implement "a public policy" "through both its courts and its Legislature" in order "to protect a franchisee in the interstate market." *Id.* at 22, 24. The Attorney General's position demonstrates that extraterritorial application of the NJFPA cannot be attributed to the parties' private agreement and is directly traceable to the State itself.

ISI repeatedly claims that the NJFPA did not compel the parties to enter into a multistate agreement or to make the agreement exclusive. ISI Opp. 3, 8, 10. But ISI does not and cannot deny that the parties' "private decision making," ISI Opp. 9, provided that the agreement was to be governed by California law and that it would expire on July 31, 1989. After that date, it is solely the NJFPA, not any agreement of the parties, that would obligate CCC to distribute exclusively through ISI in Connecticut, Delaware, the District of Columbia, and five additional States. The NJFPA does not require the parties to enter into an exclusive multistate arrangement, but it forces them to renew that

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[2]/(...continued)
embodied in the NJFPA, to protect New Jersey distributors even when they act outside the State, whatever the parties' own contract may say. The Commerce Clause issue is unlikely to arise again in such pristine form.

agreement, potentially in perpetuity, even though their own "volitional action" expressly provided otherwise.

ISI compares this case to one in which the parties voluntarily agree to reflect the provisions of the NJFPA in their contract. ISI Opp. 9. Yet that example is the very opposite of this case. Here, the parties' choice of law and termination date were overridden by the New Jersey statute. Indeed, the Third Circuit *affirmed* the district court's ruling that ISI could not assert a common-law breach of contract claim because, as a matter of law, the CCC-ISI 1984 Agreement was clear on its face and expired in 1989. Pet. App. 29a, 230a. As the New Jersey Supreme Court explained, "nothing indicates that CCC intended or agreed that the New Jersey law would cover its activities in the sister states of New Jersey." Pet. App. 128a-129a. The state court recognized that the NJFPA has extraterritorial scope *not* because of the parties' contract but rather because "the New Jersey Legislature intended the Act to apply to franchise activities outside of the state." Pet. App. 129a. Like the Illinois statute this Court found preempted in *American Airlines, Inc.* v. *Wolens*, 1995 U.S. LEXIS 690, No. 93-1286 (U.S. Jan. 18, 1995), the New Jersey statute "is prescriptive" and "does not simply give effect to [the parties'] bargains."[3] *Id.* at *16, 17.

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[3] The New Jersey Supreme Court explained that the NJFPA's extraterritorial application was attributable to "State power." Pet. App. 129a. Ignoring the decision of the state *supreme* court, ISI resorts to quoting from the state *superior* court to support its claim that the NJFPA's extraterritorial effect is attributable to private agreement rather than state law. *See* ISI Opp. 4 (citing RA3). But the state's highest court disagreed. ISI's attempt in these circumstances to deny the existence of "state independent action" (ISI Opp. 9) is also flatly foreclosed by long-settled principles of state action, as the Petition explained (at 23-24), and as neither respondent makes any effort to deny. Whether one accepts, for purposes of preemption analysis of a specific federal statute, the *American Airlines* distinction between state-imposed regulation and enforcement of the terms of private agreements set by the parties themselves, or treats the statute's preemptive reach as going further, as two Justices of this Court would have in *American Airlines*, there can be no doubt whatsoever that the instant case involves an assertion by New Jersey of the power to override the contractual regime the parties chose for themselves in States outside New Jersey.

3. ISI's argument illustrates the Third Circuit's dangerous blueprint for evasion of the Commerce Clause. ISI argues, for example, that CCC "agreed to be bound" by the NJFPA because the statute was part of New Jersey law at the time of the parties' agreement. ISI Opp. 9.[4] ISI tries to rationalize the extraterritorial application of the NJFPA as a "condition imposed . . . if CCC entered into a franchise contract with a franchisee having a place of business in New Jersey." *Id.* at 10. ISI suggests that CCC "could have . . . avoided" the provisions of the NJFPA "simply by not entering into a franchise contract," *id.* at 3, and that it could have eliminated the statute's extraterritorial effects by restricting ISI's territory to New Jersey, instead of including other States. *Id.* at 3, 8, 10. As the Petition demonstrates, these arguments merely beg the question of whether New Jersey has the power, under the Commerce Clause, to apply the NJFPA to distribution activities outside its borders or to impose such "conditions" on suppliers doing interstate business with New Jersey distributors. Pet. 19–22.

4. The Attorney General contends that *Healy* and *Brown-Forman* do not apply here because "New Jersey is not attempting to distort local markets elsewhere for its own benefit." NJ Opp. 20. But extraterritorial application of the NJFPA does distort markets in other States—it requires suppliers to continue using New Jersey distributors to sell their goods in these markets even though there are more efficient distribution methods available—and it does so solely for the benefit of New Jersey's economy. In fact, the Attorney General repeatedly argues that New Jersey *must* engage in such extraterritorial regulation in order fully to vindicate the legislature's policy of protecting New Jersey franchisees. *Id.* at 3–4, 23–24, 26–27. Neither respondent disputes

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[4] This legal fiction is more legal fantasy in this case inasmuch as the parties had chosen California rather than New Jersey law; no prior court had ever applied the NJFPA extraterritorially; the New Jersey Appellate Division in this case held that the law did not apply at all to this type of distribution relationship; and the New Jersey Supreme Court itself acknowledged in its 5–2 decision (after two oral arguments) that in this case it was "adapt[ing]" legislation enacted on the model of a typical fast-food franchise "to the rapidly-evolving complexities of the computer industry and its various distribution channels." Pet. App. 85a.

our explanation of the fundamentally protectionist nature of this application of the NJFPA. Pet. 14. And extraterritorial projection of the NJFPA has the anomalous and indeed unprecedented effect of requiring, in States outside New Jersey, that similarly situated franchisees be treated differently based solely on their State of origin. For example, a New Jersey franchisee doing business in New Hampshire would, by virtue of the NJFPA, be effectively insulated from competition from other franchisees while a Vermont or New York franchisee doing business in New Hampshire, or even one of New Hampshire's own citizens, would have no such advantage.

5. The Attorney General also indulges in a series of apocalyptic predictions about the consequences of CCC's position. She argues that its adoption would "strip[] from the states all regulatory power having any extraterritorial effect" (NJ Opp. 14; heading), would leave interstate markets governed "by *no* law whatever" (*id.* at 26), would "fundamentally change the American legal system" (*id.* at 28) and would necessitate "a return to the *Lochner* era of *laissez faire*" (*id.* at 22). These fantastic assertions rest on a fundamental misunderstanding.

The Attorney General misses the distinction between state laws regulating interstate transactions *within* the state that produce incidental effects outside the State and state laws, like the NJFPA, that would make it *unlawful* to engage in transactions wholly *outside* the State. For example, a State may regulate the sale of securities within the State, even though such regulation has incidental interstate effects; but it may not, even to protect in-state interests, enact a securities law that also regulates "transactions which take place across state lines . . . wholly outside the State." *Edgar* v. *MITE Corp.*, 457 U.S. 624, 641 (1982) (plurality opinion). Similarly, a State may regulate the price of milk within its borders in order to protect its dairy farmers, *Nebbia* v. *New York*, 291 U.S. 502 (1934), but it may not "project its legislation into [another State] by regulating the price to be paid in that state for milk acquired there," even if such regulation is believed necessary to fully effectuate its policy, *Baldwin* v. *G.A.F. Seelig, Inc.*, 294 U.S. 511, 521 (1935).

While the Attorney General claims that CCC's position would invalidate a vast array of state unconscionability rules and other state laws, she never points to a single concrete example of such a law that imposes the kind of direct extraterritorial regulation involved here, which makes it unlawful for out-of-state residents to engage in commercial transactions outside the State. Invalidating the extraterritorial application of the NJFPA to transactions in other States does not involve *"Lochnerism"* or create a "regulatory desert." NJ Opp. 27. New Jersey is free to apply its franchise policy within its borders. And, under the Commerce Clause, it is Congress -- *not* New Jersey -- that has the power to regulate franchise activities on a regional or nationwide basis. Nor can New Jersey justify extraterritorial application of its law on the ground that "courts must apply *some* state's law to interpret [a multistate] contract." Pet. App. 24a (emphasis added). This case does not involve a rule of contract interpretation. Pet. 19. And the need to apply "some state's law" certainly does not justify an *unconstitutional* interpretation of *any* state law. Whichever state's law might be applied to interpret the contract, the Commerce Clause precludes New Jersey's legislative policy to provide extraterritorial protection to New Jersey franchisees.

6. Neither respondent makes any effort to defend the Third Circuit's crabbed construction of the *Pike* test, and in fact both Oppositions suggest that the respondents agree with us on the merits of the third question presented.[2] ISI claims this question also was not raised in the record below, suggesting that CCC's summary judgment motion in the district court, and its arguments before the court of appeals, were limited to the *per se* test. ISI Opp. 13. ISI is wrong.

As the court of appeals explained, "the parties argued the *Pike* balancing test in the district court and before us." Pet. App. 27a. The Third Circuit then specifically addressed that issue and

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[2] The Attorney General insists that the NJFPA regulates "even-handedly," but she nonetheless concedes that "the burden upon interstate commerce" must be "weighed" against "[t]he local benefits" of the law. NJ Opp. 14, 27. ISI admits that *Pike* applies even where "a state law . . . does not discriminate against out-of-state participants." ISI Opp. 12.

determined that the NJFPA is constitutional under *Pike* "from a facial standpoint." Pet. App. 27a. However, the court's decision was fatally tainted by its holding that "we do not look at the effect of the state regulation on the commerce of other states when we balance," *id.*, and that, once it is determined that there is no discrimination, "the inquiry as to the burden on interstate commerce should end." *Id.* at 29a. Hence, even if there were to be a remand, the Third Circuit's holding would bar any consideration of the extraterritorial effects of the statute. *Certiorari* plainly is proper to review the court of appeals' holding that the NJFPA could create "no incidental burdens on interstate commerce for purposes of *Pike* balancing" because it "is facially neutral as to the interstate nature of the parties' agreement." *Id.* at 28a. As the Petition shows and respondents do not deny, this holding conflicts with decisions of this Court and most of the other Circuits. Pet. 24–27.

ISI is also incorrect about the state of the record. The burdensome impact of the NJFPA is self-evident: in this case it is being invoked to force a California company to do business throughout the Northeast through a New Jersey company, in perpetuity, rather than distribute its products directly or hire an out-of-state distributor that it feels can do a better job. The undisputed record also shows how this would deprive CCC of the ability to meet rapidly changing market conditions in the computer industry.[9] Yet under the court of appeals' view of *Pike*, all this

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[9] The record shows, for example, that the parties themselves did not create a perpetual distributorship for ISI, J.A. 888, 897–99, 903, because, as ISI's owner explained, "the market changes. The computer industry is very dynamic." J.A. 897. During the term of the 1984 Agreement, the instructional learning industry began a rapid transformation from a relatively obscure collection of start-up firms to a highly competitive $300 million business dominated by Fortune 500 companies with annual sales growth of 25–30%. J.A. 876–81, 1056. CCC became increasingly concerned with ISI's performance, J.A. 904–08, and believed that ISI was losing sales because it was not pricing competitively. J.A. 327, 905. ISI was doing little or no business in eight of the eleven States in its territory, and in some States had not made *any* sales at all for years. J.A. 260, 325, 892–94, 901–02, 908. CCC also cited economic literature to support its argument that franchise termination statutes like the NJFPA have substantial effects on commerce. J.A. 1791.

and any additional evidence of actual interference with commerce in other States would be irrelevant as a matter of law.[7]

7. ISI insists that "[t]his case has no significance to anyone except ISI and CCC." ISI Opp. 15 (heading). The briefs *amici curiae* of the State of New Hampshire, the Computing Technology Industry Association, the National Association of Manufacturers and the Software Publishers Association prove the contrary. Indeed, ISI itself sought mandamus in the court of appeals because of what it described as the "overriding public importance" of the Commerce Clause question,[8] and it sought certification on the ground that this case "affects not only the parties in the instant matter but untold numbers of other New Jersey franchisees operating under agreements where the designated territory extends beyond New Jersey." J.A. 1912. Even the Attorney General sees this case as involving fundamental issues that relate "to all manner of . . . commercial transactions." NJ Opp. 28.

8. ISI argues that extraterritorial application of the NJFPA to regulate interstate distribution is "consistent with" federal policy. ISI Opp. 16 (heading). But ISI's lengthy discussion of the Automobile Dealer's Day-In-Court Act, 15 U.S.C. § 1221, *et seq.*, and the Petroleum Marketing Practices Act, 15 U.S.C. § 2801, *et seq.*, shows only that Congress has carefully restricted franchise protection legislation to these two industries. Congress has *rejected* proposals like the NJFPA, and it has specifically

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[7] ISI tries to trivialize the issues in this case by asserting that the basis for its NJFPA claim is that CCC failed to give ISI 60 days' "notice" prior to nonrenewal. ISI Opp. 5, 13. This assertion, unsupported by any citation to the record, was not raised in any of ISI's prior pleadings or briefs. It is not reflected in any judicial decision in this case. It is also indisputably untrue: CCC informed ISI in July 1988—a full year before the 1984 Agreement expired—that it did not wish to renew the agreement in the eight States. Pet. App. 40a. In January 1989, ISI signed a new agreement, expressly limiting its marketing area to New York, New Jersey, and Massachusetts, that was not to take effect until five months later when the 1984 Agreement expired. *Id.*

[8] Mandamus Brief of Plaintiff-Petitioner, Instructional Systems, Inc., Oct. 25, 1993, at 17.

refused to enact franchise legislation dealing with computers and other office products. Pet. 12 & n.9.

We believe that ISI's suggestion that the Federal Government has no interest in the questions raised by the Petition is plainly incorrect, and that the United States in fact has a strong interest here. If the Court has any question in this regard, it may wish to request the views of the Solicitor General, as it has often done in dormant Commerce Clause cases.[2/] Such a request would be particularly appropriate here inasmuch as the Justice Department, in prior testimony before Congress, has voiced serious concerns over the potential adverse impact of franchise renewal requirements on federal competition policy.

CONCLUSION

The petition for writ of *certiorari* should be granted.

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[2/] *See, e.g.*, *Barclays Bank, PLC* v. *Franchise Tax Bd.*, 113 S. Ct. 2330 (1993) (*mem.*); *Chemical Waste Mgmt., Inc.* v. *Hunt*, 112 S. Ct. 413 (1991) (*mem.*); *Itel Containers Int'l Corp.* v. *Huddleston*, 112 S. Ct. 293 (1991) (*mem.*); *Amerada Hess Corp.* v. *Director, Div. of Taxation, New Jersey Dep't of Treasury*, 484 U.S. 941 (1987) (*mem.*); *Arkansas Elec. Coop. Corp.* v. *Arkansas Pub. Serv. Comm'n*, 455 U.S. 998 (1982) (*mem.*); *Edgar* v. *MITE Corp.*, 450 U.S. 978 (1981) (*mem.*).

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